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Supreme Court of the United States

OCTOBER TERM, 1948

No. 168

THE CITY OF NEW YORK, PETITIONER,

vs.

LEWIS H. SAPER, AS TRUSTEE IN BANKRUPTCY OF SPOTLIGHT PRODUCTIONS, INC.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR CERTIORARI FILED JULY 21, 1948.

CERTIORARI GRANTED OCTOBER 11, 1948.

SUPREME COURT OF THE UNITED STATES

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[fol. 1]

IN UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

In the Matter of SPOTLIGHT PRODUCTIONS, INC., Bankrupt; LEWIS H. SAPER, as Trustee in Bankruptcy of Spotlight Productions, Inc., Appellant; LAZARUS JOSEPH, as Comptroller of The City of New York, Appellee

STATEMENT UNDER RULE 15(b)

This appeal is taken by permission of this Court granted on January 5th, 1948. It involves a review of an order made by the District Court allowing a tax claim filed by the Comptroller of the City of New York.

The Comptroller filed a tax claim with the Referee in May, 1944.

The Trustee made a motion to expunge the claim on July 1st, 1947. Thereafter, the City amended its claim, subject to the same objections. Following a hearing before Referee John E. Joyce, the objections were overruled. Upon petition to review to the District Court, the Referee's order was sustained by order dated December 9th, 1947.

The notice of appeal from the order of Judge Coxe was filed on January 7th, 1948.

The attorney for the Trustee is David Haar and the attorney for the Comptroller of the City of New York is John P. McGrath, Esq., who became attorney for the Comptroller following the resignation of Charles E. Murphy, former attorney for the City of New York.

There is no change of parties or attorneys, except as indicated.

No one was arrested and no property was attached in this proceeding.

[fol. 2] IN UNITED STATES DISTRICT COURT

ORIGINAL PROOF OF CLAIM

The claim of the City of New York as originally filed, is, in substance, as follows:

Nature of Tax	Year of Taxable Period	Total
SALES TAX (M-263454) Ch. 41 Titles E and N Administrative Code	10/21/34 to 1/5/44	750.00
Total due for Sales Tax (Sec. 7)		750.00
BUSINESS TAX Ch. 41 Titles E, O R & RR Administrative Code, L. L. 9 of 1934	1933 to 1943	250.00
Total due for Business Tax (Sec. 8)		250.00
	TOTAL	$1000.00

Together with additional interest at ½% per month until paid.

The claim was verified May 17, 1944, by Saul Berlin of the Bankruptcy Assignment Unit, on behalf of George Marlin, Special Deputy Comptroller of the City of New York.

[fol. 3] IN UNITED STATES DISTRICT COURT

AMENDED PROOF OF CLAIM

The City of New York, Office of the Comptroller, Bureau of Excise Taxes, 74 Trinity Place, New York 6, N. Y.

Reg. No. M-283454, Claim No. 14507, Docket No. 83203

File with: Hon. John E. Joyce, Referee, U. S. Court House, Foley Square, New York, N. Y.

In the Matter of SPOTLIGHT PRODUCTIONS, INC., 119 West 57th Street, New York, N. Y., Debtor

STATE OF NEW YORK,
County of New York, ss:

Louis A. Sachs, of the County of New York, State of New York, being duly sworn, deposes and says:

1. That he is the head of the Bankruptcy and Assignment Unit of the Bureau of Excise Taxes in the Office of the Comptroller of the City of New York, a municipal corporation of The State of New York, and is duly authorized to make this proof of claim on its behalf.

[fol. 4] 2. That Spotlight Productions, Inc., the above named bankrupt, was at and before the filing by or against him of the petition for adjudication of bankruptcy, and still is, justly and truly indebted or liable to said corporation in the sum of $870.43.

3. That the consideration of said debt or liability is as follows:

A schedule is attached hereto and made part hereof as if set forth in full.

4. That no part of said debt or liability has been paid, except

5. That there are no set-offs or counterclaims to said debt or liability, except

6. That said corporation does not hold, and has not, nor has any person by its order, or to deponent's knowledge or belief, for its use, had or received, any security or securities for said debt or liability except

7. That no note or other negotiable instrument has been received for such account or liability or any part thereof; and that no judgment has been rendered thereon, except

8. That demand is hereby made that the aforesaid claim be allowed and paid in full as a priority claim in advance of any distribution to creditors; and furthermore, that the said claim be entitled to the rights of a lien claimant pursuant to the provisions of the Administrative Code of The City of New York and the Bankruptcy Act.

9. That the said corporation, by its duly constituted authorities, has duly made the assessment set forth herein [fol. 5] by way of proof of claim pursuant to the provisions of the Administrative Code of the City of New York enacted for the collection of the taxes set forth therein.

Louis A. Sachs, Head of Bankruptcy and Assignment Unit of the Bureau of Excise Taxes in the Office of the Comptroller of The City of New York.

(Verified.)

SCHEDULE, ANNEXED TO AMENDED PROOF OF CLAIM

Reg. No. M283454

In the Matter of SPOTLIGHT PRODUCTIONS, INC.

Schedule of Taxes due by bankrupt at and before the filing of the petition based on audit. The City of New York by its duly constituted authorities, has duly determined the amount of taxes as more fully described below.

SALES TAX Pursuant to Ch. 41 Title "E" and "N" Administrative Code of the City of New York.	Principal of Tax	Interest to date of proof of claim	Monthly rate of interest
Taxable Period			
11/1/40 - 6/30/41			1%
7/1/41 - 5/30/42	$495.61	$341.97	1%
Total Sales Tax	$495.61	$341.97	$837.58

[fol. 6]

BUSINESS TAX

Pursuant to Ch. 41 Titles "E", "O", "R" & "RR" Administrative Code of The City of New York	Principal of Tax	Interest to date of proof of claim	Monthly rate of interest
For the privilege of doing business during the period			
11/1/40 – 6/30/41	10.88	7.83	1%
7/1/41 – 5/30/42	8.84	5.30	1%
Total Business Tax	$19.72	$13.13	$32.85

Together with additional interest for the period from the date of this proof of claim to the payment thereof, on the principal amounts stated above, at the rates permitted by law.

[fol. 7] IN UNITED STATES DISTRICT COURT

NOTICE OF MOTION OBJECTING TO CLAIM OF CITY OF NEW YORK

SIR:

Please take notice that on the annexed petition of David Haar, attorney for the trustee, a motion will be made before Hon. John E. Joyce, Referee in charge of these proceedings, at his office Room 237 in the United States Court House, Foley Square, in the Borough of Manhattan, City of New York, on the 1st day of July, 1947, at 10:30 o'clock in the forenoon, for an order expunging the claim of the City of New York in the sum of $1000.00 filed in or about May, 1944, and for such other relief as in the premises may seem proper.

Dated, New York, June 24th, 1947.

Yours, &c., David Haar, Attorney for Trustee, 270 Broadway, New York City.

To: Hon. Lazarus Joseph, Comptroller of City of New York, Municipal Building, New York City.

[fol. 8] IN UNITED STATES DISTRICT COURT

PETITION

To the Honorable John E. Joyce, Referee:

The petition of David Haar respectfully shows:

1. Your petitioner is the attorney for Lewis H. Saper, the trustee herein, and on his behalf objects to the allowance of the claim of George Marlin, Special Deputy Comptroller of the City of New York, for the sum of $1000.00, filed herein in or about May, 1944.

2. The claim on the face of its shows that it is not allowable as a claim. The sales taxes are claimed from December 10th, 1934 to January 5th, 1944, in the sum of $750.00. There is no statement annexed showing what sales were had by the bankrupt corporation on the basis of which a tax is claimed. Moreover, there couldn't have been any sales prior to December 1940, which was the date of the incorporation of the bankrupt.

3. In addition there has been a business tax imposed for $250.00 for the period of 1933 to 1943.

4. The same reason for objecting to this claim is advanced as was presented to the sales tax.

Wherefore, your petitioner respectfully prays on behalf of the trustee that the claim be rejected and expunged.

Dated, New York, June 24th, 1947.

David Haar, Petitioner.

(Verified.)

[fol. 9] In United States District Court

Minutes of Hearing

In re: Spotlight Productions, Inc., Bankrupt

Before—Hon. John E. Joyce, Referee

Adjourned Hearing on Motion re Claim of The City of New York.

New York, July 17, 1947, at 2 P. M.

Appearances

David Haar, Esq., Attorney for Lewis H. Saper, Esq., Trustee.

Jay Cohen, Esq., Assistant Corporation Counsel, Representing Claimant.

Colloquy

The Referee: Spotlight Productions.

Mr. Haar: The Trustee is ready, except that I have not had an answer yet from the respondent.

The Referee: What is the application?

Mr. Haar: To expunge the claim.

They came around and examined our books and records; and I would like to get an answer, just to see—there has been no issue joined. Therefore I will ask that the motion be granted. There is no answer by the City.

Mr. Cohen: What happened here was, we audited whatever records were available and the City prepared an amended claim; but due to stenographic troubles it has not been filed yet. I think by Monday it will be filed.

The Referee: Have you the figures here?

Mr. Cohen: Yes; I will give him the figures.

(Discussion off the record.)

Mr. Haar: I would still like to know how these figures are arrived at. I think I am entitled to, under the statute.

The Referee: We can determine that.

[fol. 10] Mr. Haar: Is that going to be your answer: that that is going to be the amount of the tax?

Mr. Cohen: We are filing an amended claim and the basis of the tax.

The Referee: The 29th at 2 o'clock.

The objections will stand as to the amended claim. File it by Tuesday.

Adjourned to Tuesday, July 29, 1947, at 2 P. M.

Adjourned Hearing on Motion re Claim of The City of New York.

New York, July 29, 1947, at 2 P. M.

Present:

David Haar, Esq., Attorney for Lewis H. Saper, Esq., Trustee.

Jay Cohen, Esq., Assistant Corporation Counsel, Representing Claimant.

The Referee: Spotlight Productions.

Mr. Haar: The Trustee is ready so far as he can be.

I think your Honor ought to know what the situation is.

Since the last time we were here the City filed what they called an amended return. The amended return is no more informative than the original one. It has been reduced to $495.61, with interest amounting to almost as much, $341; and

Another item of $10.

Now, I cannot tell whether or not that tax is correct or incorrect unless there is a statement filed, as the Bankruptcy Act requires, and the General Orders require, showing how that debt is made up.

[fol. 11] The same thing applies to the other one.

The Referee: Is the City ready?

Mr. Cohen: The City is ready.

The Referee: Are you ready to prove the assessment?

Mr. Cohen: Yes, sir.

The Referee: All right; proceed. If the assessment is proved, it will be a prima facie claim.

Call a witness.

Mr. Cohen: Your Honor, we do not have to go forward with any proof.

The Referee: Yes, you do. You have to show an assessment by the Comptroller.

Mr. Cohen: Well, we have. We have filed an amended proof of claim here.

The Referee: That is not sufficient.

(Discussion off the record.)

Mr. Cohen: Your Honor, we stand on our claim.

We are relying on the following cases of law:

In re Glotzer, et al.
Garfield Bag & Stationery Co.

The Referee: Where are the cases reported?

Mr. Cohen: We took them out of the Bankruptcy Reports. I will call you back later today.

The Referee: You have not got them here now?

Mr. Cohen: Not those two.

The others I have:

Whitney v. *Dresser*, 200 U. S. 532.
In re General Film Corp., 274 Fed. 903.
In re Hannevig, 10 Fed. 2nd 941.
And *In re Bradley*, 16 Fed. 2nd 301.
In re Lang Body Co., 92 Fed. 2nd 338, cert. denied

(I don't have the page reference to the cert. denied).

Hipp v. *Boyle*, 303 U. S. 637; and
In re Raflowitz, 37 Fed. 2nd 202.

[fol. 12] And we rely upon these cases to the extent that a verified proof of claim is prima facie in its validity, when filed.

The Referee: Have you got it with respect to a claim of distraint of the City of New York?

I have written an opinion holding that this form of claim is not sufficient.

If you will tell me where those cases are reported I will look at them. Otherwise I will adjourn this matter.

Mr. Cohen: Do you have a library?

The Referee: No. I will adjourn the matter.

Will you submit just the names of the cases and where they can be found, tomorrow or the next day.

August 12th, at 11:30.

Adjourned to Tuesday, August 12, 1947, at 11:30 A. M.

Adjourned Hearing on Motion re Claim of The City of New York.

New York, August 12, 1947, at 11:30 A. M.

Present:

David Haar, Esq., Attorney for Lewis H. Saper, Esq., Trustee.

Jay Cohen, Esq., Assistant Corporation Counsel, Representing Claimant.

The Referee: Spotlight Productions.

Mr. Cohen: Your Honor, since our last meeting Mr. Haar wrote a letter in which he stressed the fact that his objection is one to the form of the claim rather than to the claim itself. [fol. 13] If that be so, then it escaped me entirely, that that was his position.

Now, on that I would like to say something, if you don't mind, namely, the claim itself—we used the same form of claim which we have for years, and Referee Stephenson had indicated several times that he thought we ought to change the form; and a conference was arranged with him and a representative of our office——

The Referee: I think I wrote an opinion on that, February, 1944.

This form seems to have been revised in June, 1944.

Mr. Haar: I have set that forth in my objection and the argument that I made; and I believe your Honor indicated that I was more or less right.

I want to know how this very tax was made up.

The Referee: I hold that the claim is prima facie and that the burden is on the Trustee to go forward with evidence; and in support of that ruling I cite the cases: *In re Bradley*, 16 Fed. 2d 301; *In re Glotzer*, 42 Fed. Supp. 712; and *In re Garfield Bag & Stationery Co.*, 42 F. Supp. 708.

Mr. Haar: Well, your Home knows how handicapped I am——

The Referee: I do not think you are handicapped so much, Mr. Haar; because while the record may not show it, I proceeded, in the nature of a pretrial, and the City had its accountant here and he produced his figures showing how he made up the items that are the basis of the proof of claim, by the Comptroller; so that you really have something.

Mr. Cohen: I would like to add, if I may, your Honor, that I invited Mr. Haar at least ten times to come over and discuss the claim, and he never did so.

Mr. Haar: All right. Will the accountant take the stand.

[fol. 14] JOSEPH SCHLISSEL (residing at No. 108 Ross Street, Brooklyn, N. Y.) called as a witness by the Trustee, being first duly sworn by the Referee, testified as follows:

Direct examination.

By Mr. Haar:

Q. Mr. Schlissel, are you an accountant employed by the City of New York in connection with the preparation of its tax claims in bankruptcy cases?

A. I am.

Q. Are you a certified accountant?

A. No.

Q. You have had experience in auditing books, I dare say, is that it?

A. Yes.

Q. Did you have anything to do with the preparation of the figures which have been used in this amended proof of claim filed in this case?

A. Yes.

Q. What did you do?

A. I examined all the records that were made available and derived these figures from those records.

Q. What do you mean when you say you examined "all the records that were made available?" Were there any kept from you?

A. That I cannot say.

Q. What books did you examine?

A. Evidently there was a record kept——

Q. (Interposing): I am asking you what books did you examine?

A. A cash book; general journal.

Q. Anything else?

A. And in connection with that, I looked at an accountant's report.

Q. I am asking you the books of the bankrupt which you examined.

A. A cash book and a general journal.

Q. I show you a book and ask you if this is one of the books which you examined (handing).

A. Yes, sir.

Mr. Haar: I offer it in evidence.

(No objection.)

(Marked Trustee's Exhibit 1, 8/12/47.)

[fol. 15] By the Referee:

Q. What book is that?

A. That is a cash book.

By Mr. Haar:

Q. And is this another book which you examined (handing)?

A. Yes, sir.

Q. What book do you call that?

A. That is a general journal.

Mr. Haar: Please mark that in evidence.

(No objection.)

(Marked Trustee's Exhibit 2, 8/12/47.)

Q. Was it from these two books that you gathered your figures and on the basis of which you found the figure of $495.61 as the principal of the tax as indicated in the amended proof of claim?

A. That is right, yes.

Q. Will you please give me the figures which you used in order to make that determination?

A. Those figures are broken down into two periods, 11/1/40 through 7/31/41.

Q. All right.

A. There are two items in that period that were deemed taxable: Purchases of machinery and equipment amounting to $849.91; and

Sales of machinery, amounting to $12,240.97.

Making a total of $13,090.88, which is all taxable at 2%.

And the second period, 8/1/41——

(Q. (Interposing): Let's first take that first period for a minute, if you don't mind, Mr. Schlissel.

You say there was a purchase of machinery in that period?

A. That is right.

Q. Amounting to $849.91?

A. That is right; purchase of machinery for own use.

[fol. 16] Q. What is there in the books to show that the purchase was made in that year rather than a previous year and payment made in that year?

A. The period of nine months to——

Q. (Interposing): Did you understand my question, Mr. Schlissel?

A. Yes.

Q. All right; will you please answer it?

A. Well, to answer that, the figures are on the books and there are no purchase invoices made available and we assume that those purchases were made during that period.

Q. In other words, you do not know, but you are only assuming; is that your answer?

A. Well——

Q. (Interposing): Is that your answer?

A. No, that is not my answer.

The business started from 11/1/40—from all indications of the records, the business started 11/1/40, or around there; and we assumed that the purchases were made from that date on.

Q. Again I say that you do not know but you are assuming the fact on the basis of which you are giving your testimony?

A. Well, we assume everything that we see on the books.

Q. Now you say there was a sale of machinery. Do you mean to say that this machinery that was purchased for $849 was sold during that period for $12,000?

A. No, sir, it was not. The purchase of machinery and equipment is not the same machinery and equipment that is sold. That is machinery and equipment bought for their own use, of manufacturing or processing or things like that.

The sales of machinery was machinery that was manufactured for sale.

Q. Oh, you mean the machines in which the company was engaged in the business of manufacturing?

A. That is right.

[fol. 17] Q. I see.

A. Like furniture and fixtures would be taxable.

Q. I understand; all right; and you say that that amounts to $12,000, from the books as you saw it?

A. That is right.

Q. Then the total is $13,000.

2%, that is 261; is that about right, approximately?

A. It is about right. I have the two figures combined.

Q. All right; what else?

A. That is all in that period.

The second period was from 8/1/41 through 5/30/42.

Q. What did you find there?

A. The purchase of machinery and equipment, $565.

Q. Yes?

A. Rental of equipment, $1,091.50.

Q. What do you mean by that? That they rented other people's equipment?

A. That is right.

Q. For which they paid what?

A. For which they paid some weekly—it must have been some weekly or bi-weekly rental payment. About $50 every two weeks rental of machinery.

Q. How much was that?

A. $1091.50 and that is taxable.

Q. Yes?

A. And sales of machinery, $16,327.91.

Making a total of $17,984.41.

And that covers a period of ten months, of which approximately seven months, seven-tenths of that is taxable at 1%, and the other three-tenths at 2%.

Q. Have you calculated that?

A. Yes; because the months of August, September and October was still in the 2% period; and the local law, from 10/27/41 to 7/1/46, the tax has been reduced to 1%.

Q. Will you show me where in either of the books there is a record of the sale of $16,327.91?

A. Oh, here is what I wanted to show you.

The journal entry made in December, 1941, there is a credit to sales of $20,661.50; but I gave the taxpayer the benefit of the doubt, because during that period, in con- [fol. 18] junction with the examination of the accountant's report, it showed the lesser figure. So I took the lesser figure.

Q. Then the figure of $16,000 is not one that is found on the books of this bankrupt, is it?

A. No; but if I were to take the books of the bankrupt, it would be $20,000.

Q. Please answer my question. That is not on the books of the bankrupt, is it?

A. Not on the books directly, no, sir.

Q. You were using something outside of the books of the bankrupt, together with the books of the bankrupt, and you came to the conclusion that $16,000 represented the sales for that period; is that your answer?

A. That is right.

Q. And that is what you did?

A. That is right.

Q. Now, did you find in these books any records of returns of machinery?

A. No, sir.

Q. All right; now, what about the item of rental of $1091.50? Will you show me where that is found on the books of the bankrupt?

A. From the beginnning of the books—from August, 1941 on, it has been shown that there evidently was a ledger account called "Rental of Equipment."

Q. What do you mean by "evidently"? You mean it is not there, but you are assuming it to be so?

A. There is an account here called "Rental of Equipment," and it was evidently a general ledger account, folio 73.

By the Referee:

Q. Are there any figures in that book opposite the label you have just given of "Rental of Equipment"?

A. Yes, sir; "Rental of Equipment"; that is the heading of the column.

By Mr. Haar:

Q. What are those figures? Do they make up $1091.50?

A. These figures make up $1091.50. It goes right through.

Q. Let em see it.

[fol. 19] (Witness indicates to counsel.)

Q. The very first item of $60 is brought forward on that line from something else, is it not—from some prior date, is it not (indicating)?

A. Well, the money was paid out August 20th, $60. Evidently no tax.

The $60 is brought forward from a previous page (indicating).

Q. What you are showing me is a succeeding, subsequent page, not a preceding page?

A. Well, preceding page—the item of $60 is on page 56.

Q. All right; you say that is brought forward from page 56?

A. That is how the books are written up. That makes no difference.

Q. That makes no difference to you?

A. No difference whatsoever; because this cash book, the bookkeeper, or whoever wrote in here, started from the back here, November, 1940, on page 75; December on page 74—he evidently started the cash receipts from the beginning of the book and worked backwards, for cash payments—they call it brought forward.

Q. Then you went backward from August, 1941 on this page?

A. I went backward in the pages, but forward in the dates.

Q. I understand that; that is what I want to make clear. Now, under what Section of the Administrative Code is there a tax imposed on expenditures by a firm or a taxpayer?

A. Well, I cannot answer that question. I don't know the exact Section.

Q. You have been working on this thing. Why did you include an expenditure as a basis for imposing a tax?

A. That expenditure is taxable; there is no doubt about it; because it was an expenditure for the purchase—or rental of equipment.

That is a legal question.

[fol. 20] Mr. Cohen: I object to the question.

The Referee: Sustained.

Mr. Haar: Well, you tell me.

Mr. Cohen: The Sales Tax Law imposes a tax not only on sales, but also on items bought—that is, on purchases by a taxpayer, which he consumed himself in the process of manufacturing, on which no tax had been paid by him.

That is two.

And three, on the rental of items, as for example, rental of machinery and equipment, rental of automobiles, rental of vending machines and things of that sort.

Mr. Haar: In what Section of the Code will I find that?

Mr. Cohen: That is a ruling by the Comptroller.

Mr. Haar: Under what Section of the Code is that ruling made?

Mr. Cohen: A ruling made under the General Provisions of the Sales Tax——

Mr. Haar (Interposing:) What is the Section of the Code under which that tax is imposed and the ruling made?

Mr. Cohen: The Section is R-41 of the Administrative Code—or rather, N-41 of the Administrative Code. Chapter 41.

(Discussion, off the record.)

By Mr. Haar:

Q. You have concluded giving me the figures for the upper portion of this amended tax, have you?

A. The sales tax part.

Q. Yes. How did you arrive at the figures—or what figure did you use which makes up the $10.88 and the $8.84 business tax?

[fol. 21] Mr. Cohen: Are you all through with the sales tax now?

Mr. Haar: I gues- so. I am going on to something else.

The Witness: I would like to say something.

The Referee: Yes?

The Witness: In connection with the sales tax, it is the practice of the Department to estimate sales made during unexplained periods.

In this particular case the records go up to 5/30/42; and the petition in bankruptcy, or whatever it is called, was signed in January, 1944.

There is a period there of about nineteen months; and I was told by the Department to estimate sales based upon the previous sales. However, we did not do that, because the examination of various records, such as records in the Referee's office, the bank account had been closed out, records in the District Attorney's office and information received from the accountants of the firm—all those sources did not reveal any additional sales; and therefore, since we had no basis, we did not estimate that period.

By the Referee:

Q. Well, the claim only runs to May 30th, or June 30th, 1942?

A. That is right.

Q. And that period is covered by these two books, is that right?

A. That is right.

The Referee: And the other is immaterial.

By Mr. Haar:

Q. Will you answer the question I put to you regarding that little business tax that you impose? How did you arrive at that?

A. The business tax estimate is made for all sales re- [fol. 22] corded before—that is, the $28,568.88, broken down into the various local laws, for 1940 and 1941.

Q. How did you arrive at the interest of $341.97?

A. That is an average rate. We charge interest at the rate of 1% a month from the date that the return is due until the date of the claim; and for all those periods it is an average of 6%.

Mr. Haar: Will you tell me under what Section, Mr. Cohen, interest is calculated in that amount? Do you happen to know it?

Mr. Cohen: I do not have it in front of me but I will give it to you.

Mr. Haar: Yes; I would like to know about that.

That is all I have, your Honor, for this witness.

The Referee: Cross-examine.

Cross-examination.

By Mr. Cohen:

Q. Were there any sales tax returns filed for the period involved in this proceeding, namely, 11/1/40 to May 30, 1942?

A. There are no returns filed for that period.

Q. Were there any business tax returns filed for the years 1940 or 1941?

A. No business tax returns filed for those years.

Q. In examining the cash book did you find reference to a ledger by posting page totals at the end of the various columns?

A. I did.

Q. And was a general ledger made available to you?

A. No, sir.

Q. Did you ask for a general ledger?

A. Yes, sir.

Q. And what was said?

A. I don't know the exact words of Mr. Haar, but he said he didn't have it.

Mr. Haar: Those are the exact words he said; because that is the fact.

[fol. 23] Mr. Cohen: That is all.

The Referee: All right. Is there any further proof?

Mr. Haar: No; I cannot, your Honor—that is all I can do.—

The Referee: I am only interested in whether you have any further proof.

Mr. Haar: None.

The Referee: Do both sides rest?

Mr. Cohen: Yes, sir.

Mr. Haar: I do.

(Closing arguments by counsel.)

(Briefs to be submitted in two weeks.)

[fol. 24] IN UNITED STATES DISTRICT COURT

REPORT OF REFEREE

The issues raised by the trustee's objections to the claim of the City of New York for sales and business taxes, superseded by an amended claim for $495.61 sales tax plus interest and $19.72 business tax plus interest, to which the objections are made applicable but were withdrawn as to the business tax principal, having been tried, I find and decide as follows:

1. The bankrupt during the period from November 1, 1940 to July 31, 1941 purchased machinery and equipment in the amount of $849.91 and sold machinery in the amount of $12,240.97, a total of $13,090.88.

2. During that period the sales tax rate was 2%.

3. Between August 1, 1941 and May 31, 1942 the bankrupt purchased machinery in the amount of $565, rented equipment at a cost of $1,091.50, and made sales to the extent of $16,327.91, a total of $17,984.41.

4. The tax rate for seven-tenths of the latter period was 1% and for the remainder was 2%.

5. No sales tax return or business tax return was filed for either period.

Conclusions

1. The bankrupt was liable for the tax imposed on sales by it of tangible personal property.

2. The bankrupt as a purchaser of tangible personal property was directly liable for the tax imposed.

[fol. 25] 3. The bankrupt was liable for a tax on the amount of rental paid or agreed to be paid to the lessor or licensor for the possession of tangible personal property.

4. The City is entitled to interest at the rate of 1% per month on the sales tax amounting to $495.61.

5. The City is entitled to interest at the rate of 1% per month on the business tax amounting to $19.72.

6. The City is entitled to interest on the principal sums of such taxes to the date of payment.

Opinion

The second conclusion is supported by *McGoldrick* v. *Berwind White Coal Mining Company*, 309 U. S. 33; *Kesbec* v. *McGoldrick*, 278 N. Y. 293, 297; *Merchants Refrigerating Co.* v. *Taylor*, 275 N. Y. 113, 124. Concerning the third, a transfer of possession for a consideration is defined as a sale by the Administrative Code of the City of New York, Sec. N 41-1.0. That definition is valid: *United Artists Corporation* v. *Taylor*, 273 N. Y. 334, 341.

The trustee's assertion that more than simple interest is a penalty finds some support in the Administrative Code which provides "Penalties and Interest" in Sec. N 41-17.0 on sales taxes and in Sec. O 41-14-0 on business taxes. The former provides a penalty of 5% and the latter 10% on the amount of the tax. In both that penalty is followed by

> plus interest at the rate of one per centum of such tax for each month of delay excepting the first month after such return was required to be filed or such tax became

due; but the controller or as provided in section N 41-13.0 the treasurer *if satisfied that the delay was excusable may remit all or any part of such penalty,* [fol. 26] *but not interest at the rate of six per cent per year* (emphasis added).

It is fairly inferable from the above language that the imposition of a charge of more than 6% per annum is punishment for a wilful or inexcusable failure to file a return and pay the tax timely and as such it has the elements of a penalty, but authorities hold otherwise and must be allowed here. *In re Gandolfi & Co. Inc.*, 42 F. Supp. 706; *In re Flayton*, 42 F. Supp. 1002; *Cf. In re Sermon*, 80 F. (2d) 81; *In re Beardsley* v. *Wolcott Mfg. Co.*, 82 F. (2d) 239.

The authorities, with an exception made recently, *In re Union Fabrics*, unreported, see N. Y. Law Journal, August 2[illegible] 1947, hold that tax claims carry interest to the date of payment. *Dave* v. *Green* 133 F. (2d) 451; *In re Gandolfi & Co. Inc., supra; In re Flayton, supra.* The case of *Vaston Committee* v. *Green*, 329 U. S. 156, did not deal with a tax claim but with compound interest to a secured creditor. Objections overruled. Settle order on notice.

September 10, 1947.

John E. Joyce, Referee in Bankruptcy.

[fol. 27] IN UNITED STATES DISTRICT COURT

ORDER OF REFEREE

The City of New York, having filed with the Referee on May 19, 1944 a proof of claim alleging that the bankrupt is justly and truly indebted to the City of New York for sales taxes with interest as provided for by statute to the date of payment of said claim, which taxes accrued over the period beginning December 10, 1934 and ending January 5, 1944, in the amount of $750, with interest to accrue thereafter, and for New York City business taxes, which accrued during the period 1933-1943 in the amount of $250, with interest to accrue thereafter; and the trustee, by notice of motion, dated June 24, 1947, and petition verified June 24, 1947, having moved for an order to reject and expunge said proof of claim of the City of New York; and the City of New

York having superseded its proof of claim by filing with the Referee herein on July 18, 1947 an amended proof of claim alleging that the bankrupt is justly and truly indebted to the City of New York for New York City sales taxes, which accrued over the period beginning November 1, 1940 to May 30, 1942, in the principal sum of $495.61, with interest which had accrued thereon to July 18, 1947 in the sum of $341.97, and additional interest at the rate of one per cent per month on the principal until the date of payment of said claim pursuant to Chapter 41, Titles "E" and "N" of the Administrative Code of the City of New York, and for New York City business taxes, which accrued during the period from November 1, 1940 to May 30, 1942, in the principal amount of $19.72, with interest thereon to July 18, 1947, in the sum of $13.13, and additional interest at the rate of one per cent per month on said principal amount until the date of payment thereon, pursuant to Chapter 41, Titles [fol. 28] "R" and "RR" of the Administrative Code of the City of New York; and the trustee's notice of motion, dated June 24, 1947, petition and objections verified June 24, 1947, having been duly made applicable to the aforesaid amended claim of the City of New York except as to the trustee's objection to the claim of the City of New York as to the principal amount of said claim for business taxes in the sum of $19.72 which objections were withdrawn, but not as to the claim for interest thereon; and after taking testimony upon said petition and objections and in opposition thereto on August 13, 1947; and after hearing David Haar, Esq., attorney for the trustee, in support of said motion, and Charles E. Murphy, Esq., Corporation Counsel of the City of New York, in opposition thereto; and due deliberation having been had, and the opinion of the Referee having been filed,

Now, it is hereby:

Ordered, that the motion to expunge the amended claim of the City of New York for New York City sales and business taxes be and the same is hereby denied and that the petition therefor be and the same hereby is dismissed; and it is further

Ordered, that the amended claim of the City of New York for New York City sales taxes herein be and the same hereby is allowed as a claim entitled to priority under Section 64a(4) of the Bankruptcy Act, as amended by the Chandler

Act, in the sum of $495.61, with interest to July 18, 1947 in the sum of $341.97, and with interest thereafter at the rate of one per cent per month on the principal sum of $495.61 from July 18, 1947 to the date of payment of said claim, pursuant to Chapter 41, Title "N" of the Administrative Code of the City of New York; and it is further

[fol. 29] Ordered, that the amended claim of the City of New York for business taxes herein be and the same hereby is allowed as a claim entitled to priority under Section 64a (4) of the Bankruptcy Act, as amended by the Chandler Act, in the principal sum of $19.72, with interest thereon to July 18, 1947 in the sum of $13.13, and with interest thereafter at the monthly rate of one per cent on the said principal amount of $19.72 up to the date of payment of the said claim, pursuant to Chapter 41, Titles "R" and "RR" of the Administrative Code of the City of New York.

Dated: September 23, 1947.

John E. Joyce, Referee in Bankruptcy.

IN UNITED STATES DISTRICT COURT

PETITION TO REVIEW ORDER OF REFEREE

To the Honorable John E. Joyce, Referee:

The petition of Lewis H. Saper respectfully shows:

1. Your petitioner is the trustee of the estate of the bankrupt above named.

2. Your petitioner, feeling aggrieved by the order heretofore made in this proceeding and dated the 23rd day of September, 1947, respectfully files this petition to review said order pursuant to the Bankruptcy Act and the Rules of this Court pertaining thereto.

[fol. 30] 3. The order which your petitioner seeks to review, was the result of a proceeding brought on his behalf as trustee for an order to expunge the claim of the City of New York for sales tax and interest, as well as a business tax and interest claimed to be due to said claimant. Upon the hearing of the application, the City of New York filed an amended proof of claim, subject to the same objections to its allowance filed by your petitioner as trustee.

4. Thereafter, a hearing having been held with respect to the amount of the claim and interest due thereon, such proceedings were had that this Court made an order allowing the amended claim of the City of New York for sales tax, as a claim entitled to priority in the sum of $495.61, with interest to July 18th, 1947 in the sum of $341.97, and with interest thereafter at the rate of 1% a month on the principal sum of $495.61, from July 18th, 1947, to the date of payment of said claim.

5. The order also provided that the amended claim filed by the City of New York for business taxes be allowed as a priority in the principal sum of $19.72, with interest to July 18th, 1947, in the sum of $13.13, and with interest thereon at the rate of 1% per month on the principal sum of $19.72 up to the date of payment of said claim.

6. Your petitioner feels aggrieved by the making of said order and believes it to be erroneous in the following respects:

The order is made upon a finding that the bankrupt purchased machinery and equipment for the period from November 1, 1940 to July 31, 1941, in the sum of $849.91, and that thereupon, as a conclusion of law, the bankrupt, as a purchaser of tangible personal property, was directly liable for the tax imposed. The error complained of with respect [fol. 31] to this particular finding and conclusion, is that there is no proof that the person or persons, or corporations from whom, or from which, the bankrupt purchased the machinery and equipment in the total sum of $841.91, did not collect the tax required under the Administrative Code in the said sum of $841.91 and turned said tax over to the City of New York.

7. The conclusion of law, as your petitioner has been advised by counsel with respect to this particular item, is erroneous as a matter of law.

8. A similar error of law is presented in this petition to review with respect to finding number 3 on purchases between August 1, 1941, and May 31st, 1942, in the sum of $565.00, and for the rental equipment in the sum of $1,091.50, on which the conclusion of law by the learned Referee is to the effect that the bankrupt was liable for a tax on the

amount of said rental paid, or agreed to be paid to the lessor or licensor for the possession of tangible personal property.

9. Your petitioner is also aggrieved by the order insofar as it is based on a finding that the claimant is entitled to interest both on sales made by it and purchases made by it in the total sum of $495.61, and also that the claimant, the City of New York, is entitled to interest in the sum of $19.72 on business tax.

10. Error is also predicated on the finding of law that the claimant is entitled to interest on the principal sums of such taxes up to the date of payment.

Wherefore, your petitioner respectfully prays that the learned Referee file a certificate in review pursuant to law and the rules of this Court, so that the order made [fol. 32] herein on September 23d, 1947, may be reviewed by the District Court, and such proceedings taken thereon as may be just and proper.

Dated, New York, October 1st, 1947.

Lewis H. Saper, Petitioner.

(Verified.)

IN UNITED STATES DISTRICT COURT, SOUTHERN DISTRICT OF NEW YORK

In the Matter of

SPOTLIGHT PRODUCTIONS, INC., Bankrupt

CERTIFICATE ON PETITION FOR REVIEW

To the Honorable, the Judges of the United States District Court for the Southern District of New York:

I, John E. Joyce, Referee in Bankruptcy, do hereby certify the following:

1. Petition of Lewis H. Saper, trustee in bankruptcy, to review an order denying the petition of David Haar, his attorney, to expunge a claim filed by the City of New York;

2. Order, dated September 23, 1947, to be reviewed;

[fol. 33] 3. Petition of David Haar, attorney for trustee in bankruptcy, with notice of motion and proof of service;

4. Amended proof of claim of the City of New York;

5. Transcript of the evidence;

6. Copy of the findings and conclusions with opinion.

A statement of the facts, and the question involved appears in findings and opinion. The errors assigned are as stated in the petition for review.

October 23, 1947.

Respectfully submitted, John E. Joyce, Referee.

To be placed on the Bankruptcy Motion Calendar, Room 506, United States Court House, New York, N. Y. for hearing on October 29, 1947, and notice given by mail to:

David Haar, Esq., 270 Broadway, New York 7, N.Y.
Charles E. Murphy, Esq., Corporation Counsel, Municipal Building, New York 7, N. Y.

[fol. 34] In United States District Court

Appearances:

Charles E. Murphy, Esq., Corporation Counsel, Attorney for the City of New York. Francis I. Howley and Leroy Mandle, Esq., of Counsel.

David Haar, Esq., Attorney for Trustee.

Memorandum

Coxe, *D. J.*:

The Referee was right in holding that the bankrupt estate is liable to the City of New York for sales taxes on purchases of machinery and equipment by the bankrupt. The sales tax is imposed upon the purchaser (Section SN41-2.oe, Administrative Code, New York City), and if the purchaser fails to pay the tax to the vendor, it must be paid by the purchaser to the City Treasurer (Section SN41-2, of, Administrative Code, New York City). "The ultimate burden of the tax * * * is thus laid upon the buyer, for consumption, of tangible personal property, and measured by the sales price." *McGoldrick* v. *Berwind-White Co.*, 309 U. S.

33, 43. The purchases here were made within the City and were not for purposes of resale, and there is no evidence that the bankrupt paid any sales taxes thereon. The fact that the City may also collect from the vendor does not relieve the purchaser of his obligation to pay the tax. *Fifth Ave. Bldg. Co.* v. *Joseph*, 272, App. Div. 449. Aside from this, however, the trustee failed to offer any proof that the vendors had paid the sales taxes on the machinery and equipment purchased by the bankrupt, and it may therefore be assumed that such taxes have not been so paid.

[fol. 35] The Referee was also right in his conclusion that the City is entitled to interest on its tax claim to the date of payments. This is in accord with the general rule. *In re J. Menist & Co.*, 290 F. 947, modified on other grounds sub nom. *United States* v. *Childs*, 26 U. S. 304; 3 Collier on Bankruptcy (14th Ed.) Sec. 63.16. The argument that interest should stop with the filing of the bankruptcy petition because of the 1938 changes in Section 57n (11 U. S. C. A., Sec. 93n), and Section 64 (11 U. S. C. A., Sec. 104) does not seem to be valid, and it has been rejected by one federal appellate court. *David* v. *Green*, 133 F. (2d) 451. Sec. 57n as amended simply substitutes a statutory bar to the filing of governmental claims for a court made bar. It is designed, so far as relevant and tempered by the provision for extension, to subject such claims to the same requirements as to filing as other claims and to speed up closing of estates. Senate Report No. 1916 on H. R. 8046, 75th Cong. 3d Sess. (1938). Old Section 64b (11 U. S. C. A., Sec. 104b) provided that priority debts, which included taxes, should be "paid in full" before payment of dividends to creditors, and Section 64a as amended (11 U. S. C. A., Sec. 104a) contains the same provision. Further, Section 57j (11 U. S. C. A., Sec. 93j) has not been changed in substance and still requires the allowance of governmental debts with accrued interest thereon. There is no clear evidence of any congressional intent to depart from the general rule so long accepted. Finally, there is nothing in the record here to charge the city with the delay in payment of its claim and thus justify the Court in denying interest on equitable grounds. Cf. *In re South Coast Co.*, 22 F. Supp. 652.

The order of the Referee is affirmed.

Alfred C. Coxe, U. S. D. J.

December 1, 1947.

[fol. 36] In United States District Court, Southern District of New York

Order Dismissing Petition to Review and Affirming Referee's Order Appealed From—December 9, 1947

Lewis H. Saper, Trustee herein, having filed a petition to review the order of Hon. John E. Joyce, Referee in Bankruptcy, dated September 23, 1947, allowing the amended claim of the City of New York for sales taxes in the sum of $495.61 with interest as allowed by law to July 18, 1947 in the sum of $341.97, totaling the sum of $837.58 and with interest thereafter at the rate of 1% a month as provided by law on the aforesaid principal sum of $495.61 from July 18, 1947 to the date of payment, and for New York City business taxes in the sum of $19.72 with interest as allowed by law to July 18, 1947 in the sum of $13.13, totaling the sum of $32.85 and with interest thereafter at the rate of 1% per month as provided by law on the principal sum of $19.72 up to the date of payment of said claim, as claims entitled to priority under Section 64a(4) of the Bankruptcy Act, and the Referee having thereafter duly issued a certificate on said petition to review, and the same having duly come on for hearing before the undersigned on the 5th day of November, 1947.

Now, upon reading and filing the certificate of Hon. John E. Joyce, Referee in Bankruptcy, dated October 23, 1947, together with the exhibits and documents referred to there-[fol. 37] in, and after hearing David Haar, attorney for the trustee in support of said petition to review, and Charles E. Murphy, Esq., Corporation Counsel of the City of New York, by Leroy Mandle, Esq., of counsel, in opposition thereto, and upon filing the opinion of the undersigned dated December 1, 1947, and due deliberation having been had thereon, and good and sufficient reason appearing therefor, it is

On motion of Charles E. Murphy, Corporation Counsel of the City of New York, attorney for the claimant herein.

Ordered, that the said petition to review the order of Hon. John E. Joyce, Referee in Bankruptcy, dated September 23, 1947, be and the same is hereby dismissed; and it is further

Ordered, that the order of Hon. John E. Joyce, Referee in Bankruptcy, dated September 23, 1947, be and the same is hereby in all respects affirmed, and the claim of the City of New York for sales taxes in the sum of $495.61 with interest as allowed by law to July 18, 1947, in the sum of $341.97 and with interest thereafter as provided by law at the rate of 1% a month on the principal sum of $495.61 from July 18, 1947 to the date of payment thereof and for New York City business taxes in the sum of $19.72 with interest as allowed by law to July 18, 1947 in the sum of $13.13 and with interest as provided by law at the rate of 1% per month on the principal sum of $19.72 to the date of payment of said claim be and the same hereby is allowed as claims entitled to priority under Section 64a(4) of the Bankruptcy Act.

Alfred C. Coxe, U. S. D. J., A. C. C.

[fol. 38] In United States District Court, Southern District of New York

#83,203

In the Matter of Spotlight Productions, Inc., Bankrupt; Lewis H. Saper, as Trustee in Bankruptcy of Spotlight Productions, Inc., Appellant, vs. Lazarus Joseph as Comptroller of The City of New York, Appellee

Notice of Appeal

Sir:

Please take notice that Lewis H. Saper, as trustee in bankruptcy of Spotlight Productions, Inc., hereby appeals to the United States Circuit Court of Appeals, for the Second Circuit, from an order made in the District Court on the 9th day of December, 1947, insofar as it affirms the order of Hon. John E. Joyce, Referee, permitting the payment of interest from the date of the filing of the petition as such, and also as a priority, and the trustee also appeals from so much of said order as affirms the order of the Referee allowing the claim of The City of New York for taxes on purchases made by the bankrupt, and the trustee appeals from

[fol. 39] each and every part of such portions of the order as indicated above.

Dated, New York, January 5th, 1948.

Yours, &c., David Haar, Attorney for Appellant, 270 Broadway, New York City.

To: John P. McGrath, Esq., Corporation Counsel, Attorney for City of New York, Appellee, Municipal Building, New York City.

[fol. 40] In United States District Court

[Title omitted]

Stipulation as to Record

It is hereby stipulated and agreed that the foregoing is a true transcript of the record of the said District Court in the above entitled matter as agreed upon by the parties.

Dated, New York, February 20th, 1948.

David Haar, Attorney for Appellant; John P. McGrath, Corporation Counsel, Attorney for Appellee.

[fol. 41] Clerk's Certificate to foregoing transcript omitted in printing.

[fol. 42] UNITED STATES CIRCUIT COURT OF APPEALS
FOR THE SECOND CIRCUIT

No. 267—October Term, 1947

(Submitted May 3, 1948. Decided May 25, 1948.)

Docket No. 20977

LEWIS H. SAPER, as Trustee in Bankruptcy of Spotlight Productions, Inc., Petitioner-Appellant,

v.

THE CITY OF NEW YORK, Respondent-Appellee

Before L. Hand, Swan and Clark, Circuit Judges

Appeal from the District Court of the United States for the Southern District of New York

Petition by Lewis H. Saper, as trustee of Spotlight Productions, Inc., bankrupt, for review of an order of a referee in bankruptcy refusing to expunge the claim of the City of New York against the bankrupt for sales and business taxes and ordering the payment of the claim, together with interest at the rate of one per cent per month until the date of payment. From an order affirming the [fol. 43] order of the referee, D. C. S. D. N. Y., 75 F. Supp. 458, the petitioner appeals. Order affirmed as to the principal of the taxes, but reversed as to the interest.

David Haar, of New York City, for Appellant; John P. McGrath, Corp. Counsel, of New York City (Isaac C. Donner, Bernard H. Sherris, and Leroy Mandle, all of New York City, of counsel), for Appellee.

Clark, Circuit Judge:

The first point on this appeal concerns the validity of a claim against an estate in bankruptcy for certain sales and business taxes levied by the City of New York against the bankrupt. The trustee concedes the validity of such taxes as were levied upon the bankrupt's sales of machinery

manufactured by it, but contests the tax levied on its purchases of materials. But, as stated in the opinion below, D. C. S. D. N. Y., 75 F. Supp. 458, this is directly contrary to the law and the rulings under it. It is quite settled that both seller and purchaser may be held liable for the city sales tax, though in fact it is primarily imposed upon the purchaser, who must pay it to the City Treasurer if he has failed to pay it to his vendor. § N41-2.0, subds. e, f, of the Administrative Code, New York City. *Kosbeck, Inc.* v. *McGoldrick*, 278 N. Y. 293, 297, 16 N. E. 2d 288, 119 A. L. R. 536, reargument denied 278 N. Y. 716, 17 N. E. 2d 136; *Fifth Ave. Bldg. Co.* v. *Joseph*, 272 App. Div. 449, 71 N. Y. S. 2d 566; *City of New York* v. *Feiring*, 313 U. S. 283. The liability of the estate is clear.

The other point, however, the liability of the estate for interest upon these tax claims after bankruptcy and until [fol. 44] they are paid, is interesting, important, and difficult. Both the referee and the district court have allowed interest, at the high rate provided by the local code of one per cent per month, so that the accumulating interest is fast approaching the face of the claim.[1] The decison must affect all tax claims in bankruptcy, from those of the federal government to those of any state or subdivision thereof. The matter has been in dispute and must remain so until settled by the Supreme Court. As will appear, the members of this court are not in accord as to the result to be reached. The court as presently constituted is agreed that Judge Coxe's decision, D. C. S. D. N. Y., 75 F. Supp. 458, should be reversed. His decision, however, was in accord with *Davis* v. *Green*, 1 Cir., 133 F. 2d 451 (which had reversed a referee and a district judge), and has the support of some other district court opinions, *e.g.*, *In re Flagton*, D. C. E. D. N. Y., 42 F. Supp. 1002; and *cf. In re L. Gandolfi & Co.*, D. C. S. D. N. Y., 42 F. Supp. 706. It is contrary to the decision of Judge Bright in *In re Union Fabrics*, D. C. S. D.

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[1] The tax period involved was Nov. 1, 1940 to May 31, 1942; the petition in bankruptcy was filed Jan. 5, 1944, and the City's claim originally on May 19, 1944; the referee's order of allowance was made on July 18, 1947. In that order he allowed a sales tax of $495.61, with interest to date of $341.97, and a business tax of $19.72, with interest of $13.13, and made express provision for additional interest at the rate of 1% per month until payment.

N. Y., 73 F. Supp. 685, the appeal from which is decided herewith,[2] with the writer of this opinion alone of the court there sitting in agreement with Judge Bright. Our decision herein was perhaps somewhat foreshadowed by the remarks of Judge L. Hand in *Hammer* v. *Taffa*, 2 Cir., 145 F. 2d 447, 449, leaving the question open, and by those of Judge Swan in *United States* v. *Roth*, 2 Cir., 164 F. 2d 575, pointing out that under the recent congressional enactments tax claims [fol. 45] were treated substantially as debts of the bankrupt. It is in accord with the views of text writers, notably Messrs. Moore and Oglebay, 3 Collier on Bankruptcy, 14th Ed. 1941, ¶ 63.16, reiterated in 1946 Cum. Supp. 131, 132, also Mr. Oglebay in 17 J. N. A. Ref. Bankr. 127, 129, 130, 21 *id.* 106, 107, 22 *id.* 41, and the commentator in 61 Harv. L. Rev. 354.

For reasons both of administrative convenience and of fundamental justice and equity it has been steadily held, following the English practice, that interest does not accrue upon claims during the period of bankruptcy administration.[3] *Sexton* v. *Dreyfus*, 219 U. S. 339, 344; *Vanston Bondholders Protective Committee* v. *Green*, 329 U. S. 156, 163, 165; 3 Collier, *loc. cit. supra*. A single exception, that for tax claims, was developed judicially. It appears to have begun with *In re Kallak*, D. C., N. D., 147 F. 276, though the contemporaneous case of *In re William F. Fisher & Co.*, D. C. N. J., 148 F. 907, held to the contrary. But the *Kallak* case set the pattern and was followed by other cases, including *In re J. Monsif & Co.*, 2 Cir., 290 F. 947, which, however, allowed interest only at the legal rate. When the Supreme Court reversed this holding to allow interest at the statutory rate, though without separate discussion of our particular problem, *United States* v. *Childs*, 1924, 266 U. S. 304, the matter was considered settled. The reason for the rule was that the original Bankruptcy Act treated tax claims quite differently from other debts; instead of requiring their presentation in due course, it provided that "the court shall order the trustee to pay all taxes

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[2] *Carter, Trustee* v. *United States et al.*, 2 Cir., — F. 2d —.

[3] If, however, a sufficiency of assets develops, the claims will bear interest; and though the usual rule applies also to secured claims, yet where the security itself yields interest, or dividends, those are applicable to interest on the claims. 3 Collier, *loc. cit. supra*.

legally due and owing by the bankrupt to the United States, [fol. 46] State, county, district, or municipality in advance of the payment of dividends to creditors." § 64a, 11 U. S. C. A. § 104(a) (before amendment). Hence the trustee was, in effect, compelled to search them out. So taxes were in altogether a separate class; they were to be paid before any administration of the estate, properly speaking, and thus had an absolute priority over the bankrupt's debts. In view of this peculiarly favored position, the like result as to interest was certainly not unnatural, even if not compelled.

In 1926, however, § 64a was amended, by adding the words "in the order of priority as set forth in paragraph (b)"; and of the seven priorities provided in (b), taxes came sixth or next to the last. Even that change might have been considered sufficient to reduce taxes to the status of debts in view of the obvious doubt as to the payment of interest upon a sixth claim in a series where the earlier five admittedly carried none. Moreover, § 64b spoke of the debts "to have priority" in advance of the payment of dividends to creditors, "and to be paid in full out of bankrupt estates," in the order then stated; it was at least odd to think that a wage claim up to $600 was "paid in full" when paid without interest, whereas a tax claim of later priority was not so paid until interest of 12 per cent or more was included.[1] But the issue did not come before the Supreme Court; and apparently the lower federal courts continued their former practice. *Cf. Horn* v. *Boone County, Neb.*, 8 Cir., 44 F. 2d 920; *In re Simon*, D. C. Conn., 11 F. Supp. 18, modified on other grounds 2 Cir., 80 F. 2d 81.

At any rate the process of assimilation of tax claims to other debts appears, to us at least, to have been completed by the Chandler amendments of 1938. Indeed we thus described the changes in *United States* v. *Roth*, *supra*, 164 F. [fol. 47] 2d at pages 577, 578: "By the 1938 amendments, however, taxes were classified as 'debts' within section 64, sub. a, 11 U. S. C. A. § 104, sub. a, and section 57, sub. n, 11 U. S. C. A. § 93, sub. n, was broadened to include 'all claims of the United States' and require them to 'be proved

[1] For the meaning of "paid in full" as limited to the principal, see *Hagaman* v. *Tufts*, *supra*, 145 F. 2d at page 449.

and filed in the manner provided in this section." Subdivision a of section 57, 11 U. S. C. A. § 93, sub. a, provides that a proof of claim shall state among other matters "that the claim is justly owing from the bankrupt to the creditor"; * * * Thus it is apparent that the Act, as it now stands, treats the tax claim as a debt and the United States as a creditor which, like other creditors, must make proof of claim on a form" prescribed by the Supreme Court. Thus, then, took from tax claims their former favored position where no proof or other governmental action was necessary for their enforcement. Thenceforth they must be proved, or otherwise be barred, just like other debts of the bankrupt.

We see no reason to suppose that this did not place tax claims in the same situation as other debts with respect to interest also. The chief ground taken in *Daze* v. *Green*, *supra*, and the other cases which argue for the priority of interest, as well as principal, though conceding its inequity, [fol. 48] is that Congress by failing to exclude it has re-enacted the old rule. It is dubious at best to rely upon such congressional adoption where "a close scrutiny of the various reports and hearings on the Chandler Act or its predecessor bills reveals nothing to indicate that the prob-

* In addition, by these amendments the priority subdivision formerly § 64b became § 64a, and the classes of priorities were changed to five instead of seven, the status of tax claims being still next to the last or (4) instead of (6). This was no advancement in position, since former classes (1), (2), and (3) were combined with (1). In 1946, there was added to (1) "the fees for the referees' salary fund and for the referees' expense fund." [This note is not a part of the quotation.]

" By making a tax claim a debt of the bankrupt it is brought within the terms of § 63a, 11 U. S. C. A. § 103(a), defining provable debts, of which subd. (1) allows interest only up to the filing of the petition, and subd. (5) includes provable debts reduced to judgment after filing, but less costs incurred and interest after the filing. Hence under subd. (5), when a tax claim is reduced to judgment after the filing, interest must be deducted. This points up the anomaly of another rule for tax claims not reduced to judgment.

lem was ever under consideration." 3 Collier on Bankruptcy, 1946 Cum. Supp., at n. 28a of ¶ 63.16; 61 Harv. L. Rev. 354. But it is submitted with deference that the pinch is on the other foot. When Congress provided that taxes must be proven like other debts and put them in, and well down in, a hierarchy of other claims, none of which bore interest, we think that like treatment was intended unless some specific exception was stated. This seems all the more likely when we recall the dubious and uncertain history of the original judicial exception.

This conclusion seems to us fortified by arguments of practicality and convenience—if not of equity, as stressed by Judge Bright—which would naturally appeal to legislators or draftsmen, if a careful exploration of the subject is to be attributed to them. Of course, the allowance of accruing interest to the various state and governmental units "would necessitate constant rescheduling and recomputation of dividends available." 61 Harv. L. Rev. 354, 355. And the net result will be to promote tax claims beyond what seems the clear intent of the statute.[7] Moreover, with the very heavy interest rates now collected by states and municipalities and upheld in *Meilink* v. *Unemployment Re-*
[fol. 49] *serves Commission of State of California*, 314 U. S. 564, it is apparent that any bankrupt estate whose settlement is delayed for any period of time is likely to be eaten up by the accruing interest on the various taxes now levied against business enterprises. As Referee Hunt points out, 17 J. N. A. Ref. Bankr. 121, 122, no trustee can afford to resist any tax claims, even with proper defenses. With interest accruing thus rapidly, he must settle at once and stop the increase in amount. True, it is suggested that this will be a boon to failing debtors who otherwise might

[7] Assume a bankrupt to owe $1,000 to an employee for wages, $1,000 each to three taxing authorities, and $1,000 for rent given priority under state law. Under ¶ 64a, which gives priority to the amount of $600 for wages and allows the others in order, these would be all paid in full if the assets were $5,000 and there were no other general claims beyond the $400 balance on the wage claim. But with interest allowed on the tax claims at 12% (or perhaps more) per annum, during the bankruptcy, possible payments on the later claims would diminish in size as rapidly as Alice in Wonderland.

be forced to the wall by rapacious tax collectors driven to precipitous action because the claims do not bear interest. But this is based upon an assumption both of alertness upon the part of taxing officials and of the importance of this lone item in the tax structure of municipalities and the state and federal governments which seems to us to have little connection with reality.

Two further arguments of claimants must be noted. One is as to § 57j, an old provision of the law stating that debts owing the United States or any State or subdivision thereof as a penalty or forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained "and such interest as may have accrued thereon according to law." Whether this has any meaning beyond the penalty or forfeiture cases we do not need to consider, for it seems clearly to be operable only *after* the question as to what, if any, interest is legal has been decided.[8] The other is that, since [fol. 50] tax claims, if unpaid, are not discharged in bankruptcy, then the unpaid interest on tax claims will survive against the bankrupt even after payment of the tax claims themselves. No cases appear yet to have held that interest thus survives beyond the principal claim which gives it birth. But assuming *arguendo* that interest is not discharged upon payment of the tax claim, we do not see how that fact can be decisive on the present issue. When the Chandler Act was under consideration, the House bill made taxes dischargeable, while the Senate amendment retained existing law. Sen. Rep. No. 1916, 75th Cong., 3d Sess., 4, stated that the committee felt "that if Federal taxes were made dischargeable, it would open the door to evasion. The Treasury Department recommended against the House amendment." Thus this was done to protect the revenue,

[8] In the companion case, the United States devotes much attention to various of the federal revenue laws and congressional debates as to changes in them with respect to interest against estates held by fiduciaries. But these do not offer any clear-cut solutions in themselves and are hardly available to change the stated priorities of a bankruptcy act. Obviously the intent of the latter is to treat federal, state, and municipal tax claims alike; it would be quite improper to accord the former alone some advantage based upon some newly discovered other federal law or regulation.

and consideration for, or against, the bankrupt was not an issue. The fact that the bankrupt may not have received an immunity he might desire is not ground for upsetting the statutory scheme of distribution of the estate in the hands of the trustee. The point is academic here—as it will often be—since the bankrupt is a corporation whose existence will be brought to an end by the bankruptcy.

Accordingly the order on appeal will be affirmed to the extent that it refuses to expunge the tax claims, but will be reversed so far as it allows interest after the filing of the petition on January 5, 1944.

Order affirmed in part and reversed in part.

[fol. 51] UNITED STATES CIRCUIT COURT OF APPEALS
SECOND CIRCUIT

At a Stated Term of the United States Circuit Court of Appeals, in and for the Second Circuit, held at the United States Courthouse in the City of New York, on the 25th day of May one thousand nine hundred and forty-eight.

Present: Hon. Learned Hand, Hon. Thomas W. Swan, Hon. Charles E. Clark, Circuit Judges.

In the Matter of SPOTLIGHT PRODUCTIONS, INC., Bankrupt; LEWIS H. SAPER, as Trustee, etc., Appellant; LAZARUS JOSEPH, as Comptroller, etc., Appellee

Appeal from the District Court of the United States for the Southern District of New York

This cause came on to be heard on the transcript of record from the District Court of the United States for the Southern District of New York, and was argued by counsel.

On Consideration Whereof, it is now hereby ordered, adjudged, and decreed that the order of said District Court be and it hereby is affirmed to the extent that it refuses to expunge the tax claims; but reversed with costs so far as it allows interest after the filing of the petition on January 5, 1944, in accordance with the opinion of this court.

It is further ordered that a Mandate issue to the said District Court in accordance with this decree.

Alexander M. Bell, Clerk.

[fol. 52] [Endorsed:] United States Circuit Court of Appeals, Second Circuit. In re Spotlight Productions, Inc., Lewis H. Saper, as Trustee, etc., Lazarus Joseph, as Comptroller, etc. 267. Judgment. United States Circuit Court of Appeals, Second Circuit. Filed May 25, 1948. Alexander M. Bell, Clerk.

[fol. 52] Clerk's Certificate to foregoing transcript omitted in printing.

[fol. 54] SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI—Filed October 11, 1948

The petition herein for a writ of certiorari to the United States Court of Appeals for the Second Circuit is granted, and the case is transferred to the summary docket.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

Endorsed on Cover: Enter John P. McGrath. File No. 53,170. U. S. Circuit Court of Appeals, Second Circuit. Term No. 168. The City of New York, Petitioner, vs. Lewis H. Saper, as Trustee in Bankruptcy of Spotlight Productions, Inc. Petition for writ of certiorari and exhibit thereto. Filed July 21, 1948. Term No. 168 O. T. 1948.

LIBRARY
SUPREME COURT, U.S.

TRANSCRIPT OF RECORD

Supreme Court of the United States

OCTOBER TERM, 1948

No. 200

STATE OF NEW YORK, PETITIONER,

vs.

LEONARD H. CARTER, AS TRUSTEE IN BANKRUPTCY

No. 201

THE UNITED STATES OF AMERICA, PETITIONER,

vs.

LEONARD H. CARTER, TRUSTEE OF UNION FABRICS, INC., BANKRUPT

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

PETITION FOR CERTIORARI FILED AUGUST 6, 1948.

CERTIORARI GRANTED OCTOBER 11, 1948.

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1948

No. 200

STATE OF NEW YORK, PETITIONER,

vs.

LEONARD H. CARTER, AS TRUSTEE IN BANKRUPTCY

No. 201

THE UNITED STATES OF AMERICA, PETITIONER,

vs.

LEONARD H. CARTER, TRUSTEE OF UNION FABRICS, INC., BANKRUPT

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

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JUDD & DETWEILER (INC.), PRINTERS, WASHINGTON, D. C., OCT. 25, 1948.

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IN UNITED STATES CIRCUIT COURT OF APPEALS, SECOND CIRCUIT

In Bankruptcy, No. 75,326

in the Matter of

UNION FABRICS, INC., Bankrupt

in the Matter of

The Application to disallow interest on tax claims filed by the United States of America and State of New York,

UNITED STATES OF AMERICA, Tax Claimant-Appellant,

STATE OF NEW YORK, Tax Claimant-Appellant,

LEONARD H. CARTER, Trustee-Appellee

STATEMENT UNDER RULE XV(b)

Appellee objected to the allowance by the referee of interest to the date of payment on the tax claims of the United States and the State of New York. Hearings were held before Referee Peter B. Olney on July 8, and July 22, 1946. On January 24, 1947, the referee overruled the objections. On February 13, 1947, the hearing on objections was reopened by consent and the referee adhered to his decision of January 24, 1947. On review, by orders dated August 21, 1947, Hon. John Bright reversed the referee from which orders the United States and the State of New York appeal. [fol. 2] By stipulation, an agreed statement of facts was entered into and the contents of the transcript of the record was designated to include so much of the papers as is germane to this appeal.

Hon. John F. X. McGohey, United States Attorney, Wm. M. Regan, Esq., Assistant United States Attorney, of Counsel, United States Court House, Foley Square, New York, N.Y., appears for the United States.

Hon. Nathaniel L. Goldstein, Attorney General of the State of New York, The Capital, Albany, N. Y., appears for the Tax Claimant, the State of New York.

Parker, Chapin & Flattau, Esqs., Sydney W. Cable, Esq., of Counsel, 285 Madison Avenue, New York, N.Y., and Glass & Lynch, Esqs., 170 Broadway, New York N.Y., appear for the Trustee.

There has been no change of parties or attorneys.

IN UNITED STATES DISTRICT COURT, SOUTHERN DISTRICT OF NEW YORK

In Bankruptcy No. 75,326

STIPULATION AS TO CONTENTS OF RECORD

Pursuant to Rule LXXV (f) of the United States Rules of Civil Procedure, counsel for the respective parties hereto hereby designate the parts of the record, proceedings, and evidence to be included in the record on appeal as follows:

1. The annexed Agreed Statement of Facts;

[fol. 3] 2. Notice of Appeal, filed on September 23, 1947, on behalf of the United States of America;

3. Notice of Appeal, filed on September 17, 1947, on behalf of the State of New York;

4. Order of the District Court, dated August 21, 1947, sustaining trustee's petition for review of order of referee entered in favor of the United States of America;

5. Order of the District Court, dated August 21, 1947, sustaining trustee's petition for review of order of referee entered in favor of the State of New York;

6. Consolidated decision of the District Court, dated August 13, 1947, sustaining petitions for review and reversing orders of referee;

7. Certificate of the Referee, dated March 5, 1947.

8. Consolidated memorandum of referee, dated January 24, 1947, overruling objections to allowance of interest beyond the date of the filing of the petition in bankruptcy;

9. Referee's Findings of Facts and Conclusions of Law dated January 24, 1947, on trustee's objections to claims of the State of New York;

10. Referee's Findings of Facts and Conclusions of Law dated January 24, 1947, on trustee's objections to claims of the United States of America (only portions which relate to the issue of payment of interest);

[fol. 4] 11. Minutes of hearing before referee held on February 13, 1947.

Dated: New York, New York, January 21, 1948.

John F. X. McGohey, United States Attorney for Southern District of New York, Attorney for the United States of America, Tax Claimant-Appellant, By: Wm. M. Regan, Assistant United States Attorney, Nathaniel L. Goldstein, Attorney General of the State of New York, Attorney for the State of New York, Tax Claimant-Appellant, By: Francis R. Curran, Assistant Attorney General. Parker, Chapin & Flattau and Glass & Lynch, Attorneys for Trustee-Appellee.

In United States District Court

Agreed Statement of Facts

It is hereby stipulated and agreed by and between counsel for the respective parties hereto that the following is the agreed statement of facts to form part of the record on appeal herein:

1. An involuntary petition in bankruptcy was filed herein on December 20, 1939;

[fol. 5] 2. By notices of objection, dated July 1 and 2, 1946, the trustee filed objections to demands for interest beyond the date of the filing of the petition in bankruptcy on claims of the United States of America for social security (Title VIII and IX of Social Security Act), income and miscellaneous taxes (capital stock) and on claims of the State of New York for franchise and unemployment insurance taxes;

3. Interest demanded on said claims of the United States of America and of the State of New York from December

20, 1939, the date of the filing of the petition in bankruptcy, to the dates of filing the instant notices of appeal is in excess of $500 as to each claimant.

4. After consolidated hearings, the referee on January 24, 1947 filed separate Findings of Fact and Conclusion of Law and based thereon, the referee on the same day filed a consolidated memorandum overruling the trustee's objections to the allowances of interest to the date of payment. Separate orders to the aforesaid effect were entered by the referee on February 24, 1947;

5. Following a consolidated petition and order to show cause by the trustee, dated February 6, 1947, the hearing with respect to the objections as to interest was reopened before the referee on February 13, 1947 and upon such reopening, the trustee was permitted to offer proof of certain matters set forth in his petition as follows:

(a) An involuntary petition in bankruptcy was filed herein December 20, 1939.

[fol. 6] (b) A turnover proceeding was commenced by the trustee against Abraham Jeskowitz, President of the bankrupt by petition verified October 25, 1940 and that hearings in said proceeding were held from January 27, 1941 to May 6, 1942.

(c) That a turnover order of the Referee in Bankruptcy was entered February 23, 1943.

(d) That the turnover order was affirmed upon appeal by the United States District Court for the Southern District of New York on May 6, 1943.

(e) That the turnover order was affirmed by the Circuit Court of appeals, Second Circuit on July 21, 1944.

(f) That the petition of Abraham Jeskowitz for a writ of certiorari was denied by the Supreme Court of the United States on December 11, 1944, and his petition for rehearing was denied on January 2, 1945.

(g) That the petition of Abraham Jeskowitz to reopen the turnover proceeding before the referee was denied by order of the Referee dated November 29, 1944.

(h) That the motion of Abraham Jeskowitz to the Circuit Court of Appeals for leave to petition the Referee to reopen the turnover proceeding was denied by order of the Circuit Court of Appeals, dated February 9, 1945 and the motion for reargument thereon was denied by an order dated March 9, 1945.

(i) The Supreme Court denied the petition of Abraham Jeskowitz for a writ of certiorari to review that order on May 21, 1945.

[fol. 7] (j) That thereafter an order to punish Abraham Jeskowitz was made by the District Court for the Southern District of New York on September 10, 1945.

(k) The order punishing Abraham Jeskowitz for contempt was affirmed by the Circuit Court of Appeals, Second Circuit on February 14, 1946.

(l) That petition of Abraham Jeskowitz for a writ of certiorari was denied by the Supreme Court of the United States on May 6, 1946.

(m) That thereafter, Abraham Jeskowitz, pursuant to the contempt order dated September 10, 1945 was incarcerated in the Federal House of Detention.

(n) That an offer of settlement of all claims of the Trustee against Abraham Jeskowitz was accepted at a special meeting of creditors held on July 8, 1946 and the Trustee was authorized to accept said settlement and release Abraham Jeskowitz of all claims by the order dated July 15, 1946.

(o) That the total amount of allowed claims filed in this proceeding is $89,128.76.

(p) That the claims of the United States of America aggregate $9,865.35, the claims of the People of the State of New York aggregate $1,660.92, and that both aggregate $11,526.27.

(q) That the amount of interest, at the rate of six per centum (6%) per annum, on $11,526.27 from December 20, 1939 to February 6, 1947, the date of the trustee's petition to reopen the proceedings, is $4,930.08.

[fol. 8] (r) That the assets of the estate prior to receipt of the amount of the settlement payment of $30,000 was $19,888.11 in cash on deposit in two banks and a small lot of merchandise which the Trustee has been unable to get any bids upon.

(s) That the priority tax claims of The City of New York were allowed herein in the compromised amount of $3,564.70, inclusive of interest;

(t) That the interest claimed by the United States of America on its tax claims to the date of the filing of the petition in bankruptcy herein aggregated at least $1,026.67, and that the interest claimed by the State of New York on its tax claims to the date of the filing of the petition in bankruptcy herein aggregated $206.92.

6. At the reopened hearings on said February 13, 1947, the objections by the tax-claimants to the offer of proof of the matters set forth above were sustained by the referee on the ground that the issue was one of law and equitable considerations were therefore irrelevant and immaterial. This ruling of the referee was embodied in separate orders dated February 24, 1947, the same orders referred to in paragraph "4" above.

7. On March 3, 1947, the trustee petitioned for review of the said orders of the referee, dated February 24, 1947, which sustained the objections to the trustee's offer of proof and overruled the trustee's objections to the allowances of interest.

8. On review, Hon. John Bright, United States District Judge, by a consolidated decision, dated August 13, 1947, sustained the petitions for review and reversed the orders of the referee allowing interest on the claims of the United States of America and of the State of New York from the date of the filing of the petition to the date of payment and sustaining the objections to the trustee's offer of proof at the rehearing. Separate orders to the aforesaid effect were made on August 21, 1947 and thereafter entered on August 28, 1947.

9. The United States of America and the State of New York, by notices of appeal filed on September 23, 1947 and [fol. 9] September 17, 1947, respectively, appeal from the

aforesaid orders of the District Court made and entered on said decision.

10. The facts are not in dispute. The main issues presented are:

(a) whether it was mandatory under the law for the court of bankruptcy to allow so much of the tax claims of the United States and State of New York as constituted interest from the date of the filing of the petition to the date of payment;

(b) whether equitable considerations are relevant to a determination of the right of taxing agencies to such interest.

Dated: New York, New York, January 21, 1948.

John F. X. McGohey, *United States Attorney for Southern District of New York, Attorney for the United States of America, Tax Claimant-Appellant*, By: *Wm. M. Regan, Assistant United States Attorney.* Nathaniel L. Goldstein, *Attorney General of the State of New York, Attorney for the State of New York, Tax Claimant-Appellant*, By: Francis R. Curran, *Assistant Attorney General.* Parker, Chapin & Flattau and Glass & Lynch, *Attorneys for Trustee-Appellee.*

[fol. 10] IN UNITED STATES DISTRICT COURT

[Title omitted]

NOTICE OF APPEAL ON BEHALF OF THE UNITED STATES—Filed September 23, 1947

SIRS:

Please Take Notice that the United States of America hereby appeals to the United States Circuit Court of Appeals for the Second Circuit from the order of the Honorable John Bright, District Judge, dated August 21, 1947, entered in this proceeding on August 28, 1947, sustaining the Trustee's petition for review, reversing the order of the Referee which allowed interest from the date of the filing of the petition in bankruptcy to the date of payment on the claims

of the United States of America and sustaining the objections to the Trustee's offer of proof at the rehearing and from each and every part thereof.

Dated: New York, N. Y., September 22, 1947.

John F. X. McGohey, *United States Attorney for the Southern District of New York, Attorney for Appellant.* By: William M. Regan, *Assistant United States Attorney,* Office & P. O. Ad-ress, United States Court House, Foley Square, New York 7, N. Y.

[fol. 11] To: Clerk, United States District Court, Southern District of New York, U. S. Court House, Foley Square, New York, N. Y.

Parker, Chapin & Flattau, Esqs., 285 Madison Avenue, New York, N. Y., Glass & Lynch, Esqs., 170 Broadway, New York, N. Y., Attorneys for Leonard H. Carter, Trustee-Appellee.

IN THE DISTRICT COURT OF THE UNITED STATES

[Title omitted]

NOTICE OF APPEAL ON BEHALF OF THE STATE OF NEW YORK

Notice is hereby given that the State of New York, a tax claimant for unemployment insurance and franchise taxes, hereby appeals to the Circuit Court of Appeals for the Second Circuit from the order of Hon. John Bright, District Judge, dated the 21st day of August, 1947, entered in this proceeding on the 28th day of August, 1947, sustain-[fol. 12] ing the trustee's petition for review, reversing the order of the referee which allowed interest on the claims of the State of New York for unemployment insurance and franchise taxes from the date of the filing of the petition to the date of payment and which further sustained the objections to the trustee's offer of proof at the rehearing, and the State of New York appeals from each and every part of said order.

Nathaniel L. Goldstein, Attorney General of the State of New York, Attorney for State of New York, Tax Claimant-Appellant. By Francis R. Curran, Assistant Attorney General, Address—Standard Building, 112 State Street, Albany, New York.

To: Clerk of the above Court. Parker, Chapin and Flattau, Esqs., 285 Madison Avenue, New York 17, N. Y. and Glass & Lynch, Esqs., 170 Broadway, New York 7, N. Y., Attorneys for Leonard H. Carter, Trustee-Appellee.

[fol. 13] IN UNITED STATES DISTRICT COURT

[Title omitted]

NOTICE OF ENTRY OF ORDER

SIR:

Please take notice that the within is a true copy of an order made August 21st, 1947 and entered herein this day in the office of the Clerk of the United States Court for the Southern District of New York.

Dated: New York, N. Y., August 28, 1947.

Yours etc., Parker, Chapin and Flattau, Esqs., 285 Madison Avenue, New York 17, N. Y., and Glass & Lynch, Esqs., 170 Broadway, New York, N. Y., Attorneys for Trustee.

To: Hon. John F. X. McGohey, United States Attorney, United States Court House, Foley Square, New York, N. Y.

[fol. 14] IN UNITED STATES DISTRICT COURT, SOUTHERN DISTRICT OF NEW YORK

In Bankruptcy No. 75,326

In the Matter of UNION FABRICS, INC., Bankrupt

ORDER SUSTAINING TRUSTEE'S PETITION FOR REVIEW

Leonard H. Carter, Trustee in Bankruptcy in the above entitled matter, having filed a petition to review so much of the order of Hon. Peter B. Olney, Referee, as overruled the Trustee's objections to the allowance of interest on the claims of the United States of America filed herein from the date of the filing of the petition in bankruptcy herein to the date of payment of said claims and to review the rul-

ing of said Referee sustaining objections to the admission of evidence with respect to the Trustee's offer of proof as to the matters set forth in said Trustee's petition dated February 6, 1947, and the same having regularly come on to be heard before me on April 23, 1947,

Now, upon reading and filing the five claims of the United States of America, as follows: $113.91, verified January 13, 1940; $1,594.56, verified February 15, 1940; $46.56, verified April 3, 1940; $8,059.49, verified June 13, 1940 and $60.83, verified July 10, 1940; the Trustee's notice of objections to said claims and notice of a hearing thereon, dated July 2, 1946; the petition of the Trustee, verified February 6, 1947 and the order to show cause thereon, dated February 6, 1947, why an order should not be made reopening the hearing with respect to the objections of the Trustee to said claims; the order of the Referee entered thereon, [fol. 15] dated February 24, 1947; the Trustee's petition for review, verified March 3, 1947; the certificate of the Referee upon said petition to review, dated March 5, 1947; and the minutes of testimony and exhibits accompanying the same; and after hearing the adverse interests herein to-wit: Parker, Chapin and Flattau, Esqs., and Glass & Lynch, Esqs., by Sydney W. Cable, Esq. of counsel, attorneys for the Trustee, in support of the petition to review and John F. X. McGohey, Esq., United States Attorney, by Frank J. Stella, Esq. of counsel, Attorney for the United States of America, in opposition thereto and due deliberation having been had and the opinion of the Court dated August 13, 1947 having been filed; it is on motion of Parker, Chapin and Flattau, Esqs., and Glass & Lynch, Esqs., attorneys for the Trustee,

Ordered, that the Trustee's petition to review be and the same hereby is sustained; that the orders of the Referee insofar as they allow interest from the date of the filing of the petition in bankruptcy to the date of payment on the sustaining the claims of the United States of America and [refusing to] J. B. objections to the trustee's offer of proof at the rehearing [consider the equities presented by the records in this proceeding,] * be and the same hereby are reversed.

Dated New York, N.Y., August 21st, 1947.

John Bright, U. S. D. J.

* Struck out in copy.

[fol. 16] In United States District Court

[Title omitted]

Notice of Entry of Order

Sir:

Please take notice that the within is a true copy of an order made August 21st, 1947 and entered herein this day in the office of the Clerk of the United States Court for the Southern District of New York.

Dated New York, N. Y., August 28, 1947.

Yours etc., Parker, Chapin and Flattau, Esqs., 285 Madison Avenue, New York 17, N. Y. and Glass & Lynch, Esq., 170 Broadway, New York, N. Y., Attorneys for Trustee.

[fol. 17] To: Nathaniel L. Goldstein, Esq., Attorney General of the State of New York, The State Tax Commission, 80 Centre Street, New York, N. Y.; Nathaniel L. Goldstein, Esq., Attorney General of the State of New York, New York State Department of Labor, 342 Madison Avenue, New York, N. Y.

In United States District Court, Southern District of New York

In Bankruptcy, No. 75,326

In the Matter of Union Fabrics, Inc., Bankrupt

Order Sustaining Trustee's Petition for Review

Leonard H. Carter, Trustee in Bankruptcy in the above entitled matter, having filed a petition to review the order of Hon. Peter B. Olney, Referee, overruling the Trustee's objections to the allowance of interest on the claims of the State of New York filed herein from the date of the filing of the petition in bankruptcy herein to the date of payment of said claims and to review the ruling of said Referee sustaining objections to the admission of evidence with [fol. 18] respect to the Trustee's offer of proof as to the matters set forth in said Trustee's petition dated Feb-

ruary 6, 1947, and the same having regularly come on to be heard before me on April 23, 1947.

Now, upon reading and filing the claim of the New York State Tax Commission for $1,403.14, verified May 29, 1940 and the claim of New York State Department of Labor, Division of Placement and Unemployment Insurance, verified June 4, 1940; the Trustee's notice of objections to said claims and notice of a hearing thereof dated July 1, 1946; the petition of the Trustee, verified February 6, 1947 and the order to show cause thereon, dated February 6, 1947, why an order should not be made reopening the hearing with respect to the objections of the Trustee to said claims; the order of the Referee entered thereon dated February 24, 1947, the Trustee's petition for review, verified March 3, 1947; the certificate of the Referee upon said petition to review, dated March 5, 1947; and the minutes of testimony and exhibits accompanying the same; and after hearing the adverse interests herein to-wit: Parker, Chapin and Flattau, Esqs., and Glass & Lynch, Esqs., by Sydney W. Cable, Esq., of counsel, attorneys for the Trustee in support of the petition to review and Nathaniel L. Goldstein, Esq., Attorney General of the State of New York, by Harry Zankel, Esq., of counsel, Attorney for the State of New York, in opposition thereto and due deliberation having been had and the opinion of the Court dated August 13, 1947 having been filed; it is on motion of Nathaniel L. Goldstein, Attorney General of the State of New York, Attorney for the State of New York.

[fol. 19] Ordered, that the Trustee's petition to review be and the same hereby is sustained; that the order of the referee allowing interest from the date of the filing of the petition in bankruptcy to the date of payment on the claims of the State of New York and sustaining the objections to the Trustee's offer of proof at the rehearing be, and the same hereby are reversed.

Dated: New York, N. Y., August 21st, 1947.

John Bright, U. S. D. J.

In United States District Court, Southern District of New York

Petition for review of orders of Referee in Bankruptcy.

Appearances:

Parker, Chapin & Flattau, Esqs., 285 Madison Avenue, New York City; Sydney W. Cable, Esq., of Counsel and Glass & Lynch, Esqs., 170 Broadway, New York City, for Leonard H. Carter, Trustee.

Honorable John F. X. McGohey, United States Attorney, Frank J. Stella, Esq., of Counsel for the United States.

Honorable Nathaniel L. Goldstein, Attorney General, 342 Madison Avenue, New York City, for the New York Industrial Commissioner and State Tax Commission.

[fol. 20] Opinion

Bright, U. S. D. J.:

The Trustee seeks a review of orders of Honorable Peter B. Olney, Referee, claiming that he erred (1) in allowing interest to the date of payment, instead of to the date of the filing of the petition herein, on claims of the Collector of Internal Revenue for social security taxes for the years 1936, 1937, 1938 and 1939, income taxes for 1935 and 1936, and a miscellaneous tax for 1935, aggregating in all $9,759.44, and on claims of the New York State Tax Commission for franchise taxes for 1936, 1937 and 1938, and of the State Department of Labor for unemployment insurance taxes, aggregating in all $1,085.97; and (2) in the rejection of evidence showing the litigation which had previously ensued in this proceeding, as bearing upon the equities which the Trustee claimed should have been considered in the determination of the question of interest.

I have come to the conclusion that interest should be allowed only to the date of the filing of the petition herein, and that the facts relating to the previous litigation should have been admitted and considered.

Were the court to be controlled by the principle of *stare decisis*, the Referee's determination finds support in *Davis v. Green*, C. C. A. 1, 133 F. (2d) 451; *Matter of Summers*, 45 A. B. R. (N. S.) 123; *Matter of Dorsey*, 46 A. B. R. (N. S.) 146; *Matter of Gandolfi & Co. Inc.*, 42 F. Supp. 706 and *Matter of Flayton*, 42 F. Suppl. 1002.

But recent decisions of the Supreme Court have shown that precedent is not always to be the guiding star. A court is not to be precluded by it "against the responsible [fol. 21] exercise of the judicial process". *Helvering v. Hallock*, 309 U. S. 106, 119. And when faced with precedent the court is not without power to decide otherwise where so doing would lead to a just result. *Erie v. Tompkins*, 304 U. S. 64, 92; *Graves v. Schmidlapp*, 315 U. S. 657, 665.

In *Vanston Committee v. Green*, 329 U. S. 156, 163, 165, where in a Chapter X reorganization a claim was made by a secured creditor for interest on interest and was opposed by subordinate creditors, it was written:

> "The general rule in bankruptcy and equity receivership has been that interest on the debtor's obligations ceases to accrue at the beginning of the proceedings. Exaction of interest, where the power of the debtor to pay even his contractual obligations is suspended by law, has been prohibited because it was considered in the nature of a penalty imposed because of delay in prompt payment—a delay necessitated by law if the courts are properly to preserve and protect the estate for the benefit of all interests involved. * * * The delay in distribution is the act of the law; it is a necessary incident to the settlement of the estate. * * * Courts have felt that it would be inequitable for any one to gain an advantage or suffer a loss because of such delay. * * * It is manifest that the touchstone of each decision on allowance of interest in bankruptcy, receivership and reorganization has been a balance of equities between creditor and creditor and between creditors and the bankrupt."

The sovereign prerogative, now in some respects urged by these two priority creditors, does not present an insurmountable barrier. Except as to priority of payment of [fol. 22] principal, they are not to be considered any more favorably than the general run of creditors. *Keifer & Keifer v. Reconstruction Finance Corporation*, 306 U. S. 381, 396; *Federal Housing Administration v. Burr*, 309 U. S. 242, 245.

Some of the decisions supporting the Referee's determination question the present rule. Thus in Davie v. Green, force was conceded to the argument that the passing

of the Chandler Act had deprived tax claims of their former advantageous position as to interest in view of the inequitable and unjust effect upon general creditors. In matter of Dorsey *(supra)* the Referee in yielding to higher authority awarded the State interest to the date of payment. He nevertheless said (p. 147):

> "This may be the law, but a mere statement of the facts awakens a keen sense of injustice. If the thing is wrong and unfair, in principle, it is just as wrong and unfair when asserted by government as when asserted by an individual. If this be the law, it illustrates how the rigors of the law may well be relaxed by government to exemplify the will to do justice."

The Referee wrote in the Summers case, "I have grave doubts as to the soundness of the statement" that tax claims are to be paid in full to the date of payment. The Second Circuit held in *Hammer v. Tuffy,* 145 F. (2d) 447, 449, that since the passage of the Chandler Act the question must be regarded as an open one. And see Collier on Bankruptcy, 14 ed., vol. 3, at page 1843, where the author favors assimilating the treatment of tax claims to that of other claims, after a careful review of the changes made by the Chandler Act, showing a change in view of Congress with reference to the previous favorable treatment of tax claims.

[fol. 23] But, say the claimants, section 57j of the Bankruptcy Law is the same now as it was in 1938, and provides as then that debts owing to the United States or any state "as a penalty or forfeiture shall not be allowed except for the amount of the pecuniary loss sustained by the act, transaction or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interest as may have accrued thereon according to law"; and that it is fair to assume that Congress, in its revision by the Chandler Act, was aware of the construction placed upon the words it had previously used, and had it wished to change that construction so as to place tax claims on the same footing with other claims it would have said so. But it is suggested that the silence of Congress as to the judicial interpretation of a statute is not decisive nor any good reason why the cases should not be re-examined and a contrary construction arrived at,

Helvering v. Hallock, *supra*, at page 119, where it is written:

> "It would require very persuasive circumstances enveloping congressional silence to debar this Court from re-examining its own doctrines. To explain the cause of nonaction by Congress when Congress itself sheds no light is to venture into speculative unrealities."

To treat tax claims, so far as interest is concerned, differently than other claims, I think is neither logical, sound nor just. On the contrary such treatment is a clear anomaly and cannot be justified except upon precedent now of doubtful validity since the passage of the Chandler Act. See *People* v. *American Loan & Trust Co.*, 172 N. Y. 371, 379.

[fol. 24] Such a ruling compels payment, not by the debtor whose debt it is, but by general creditors, who did not incur it, and who were not responsible for the delay in payment, out of their otherwise fractional recovery on their own claims.

The second claimed error, in view of what has been written above, does not present any serious question. The necessitated delay in the administration of this estate, to which the Supreme Court referred in the Vanston Committee case, and which was essential in order properly to preserve and protect the estate for the benefit of all interests, is demonstrated in an unusual degree here. It does not seem to me that the Trustee was required to introduce the facts which were rejected by the Referee. The same information was always accessible to the Court from an examination of its own files. It thus appears, if equitable considerations enter into the determination here sought, that the involuntary petition was filed December 20, 1939. Turnover proceedings were commenced against the bankrupt's president in October, 1940, which resulted in an order on February 23, 1943, requiring the turnover, affirmed by the District Court on May 6, 1943, by the Circuit Court of Appeals on July 21, 1944, and certiorari was denied on December 11, 1944. During the appeal the president petitioned to reopen the matter which was denied by the Referee on November 29, 1944, the Circuit Court of Appeals also

denied his request for leave to petition the Referee to reopen on February 9, 1945, and certiorari was denied on May 21, 1945. An order adjudging the president in contempt was granted on September 10, 1945, affirmed on appeal on February 14, 1946, and certiorari denied May 6, [fol. 25] 1946. He was imprisoned and then offered to settle for $30,000., the offer was accepted by the creditors on July 15, 1946, and the estate was increased by that amount after nearly six years of litigation.

It is not denied that prior to that settlement the assets were $19,888.11. The total of the claims is $89,128.76. The tax claims in question aggregate $11,455.41. If interest to the date of payment is allowed from December 20, 1939, when the petition was filed, an additional 48% must be added, and with administration expenses would exceed the estate prior to the increase by $30,000.

The allowance of interest to the date of payment, an accumulation caused solely because of delays necessitated by the successful efforts of the Trustee to protect and increase the estate, seems to me to be entirely inequitable, and to result in an unbalance of equities between the several creditors rather than a "balance of equities" which the Supreme Court says is the touchstone of each decision. It would do more. As I have written above, it would require the general creditors to pay the penalty caused by the delay necessitated to preserve and protect the estate.

I think it is time that precedents which lead to such an anomalous, inequitable and unjust result be overruled.

The petition for review is sustained, and the orders allowing interest to date of payment and refusing to consider the equities presented by the records in this proceeding are overruled. The order to be entered hereon will be settled on notice.

Dated: August 13, 1947.

John Bright, United States District Judge.

[fol. 26] IN UNITED STATES DISTRICT COURT

CERTIFICATE OF THE REFEREE

To the Honorable, The Judges of the District Court of the United States for the Southern District of New York:

I, Peter B. Olney, the referee in charge of the above-entitled matter, do hereby certify, pursuant to § 39a (8), as follows:

The question certified for review is whether as referee I erred in making the orders dated February 24, 1947, sought to be reviewed and herewith submitted, in and by which I overruled trustee's objections to the allowance of interest on the claims of the State Tax Commission, New York State Department of Labor, Division of Placement and Unemployment Insurance, and Collector of Internal Revenue, from the date of the filing of the petition in bankruptcy herein to the date of payment of said claims, and allowed such interest. More specifically, error is claimed in the respects set forth in the petitions for review, verified March 3, 1947, and submitted herewith.

The facts are as found in referee's Findings of Fact and Conclusions of Law and Memorandum, all dated January 24, 1947, and herewith submitted.

There is also submitted herewith five claims of the Collector of Internal Revenue, as follows: $113.91, verified January 13, 1940; $1,594.56, verified February 15, 1940; $46.56, verified April 3, 1940; $8,059.49, verified June 13, 1940; and $60.83, verified July 10, 1940; the objections to said claims and notice of hearing, dated July 21, 1946; claims of the State Tax Commission for $1,403.14, verified May 29, 1940; claims of New York State Department of Labor, Division of Placement and Unemployment Insur-[fol. 27] ance in the sum of $282.83, verified June 4, 1940; objections of the trustee to the last two named claims and notice of hearing thereon dated July 1, 1946; stenographic record on said objections; petition of Leonard H. Carter, the trustee herein, verified February 6, 1947; and order to show cause hereon, dated February 6, 1947, why order should not be made reopening the hearing with respect to the objections of the trustee herein to said claims; steno-

graphic record thereon; order granting motion to certain extent dated February 24, 1947 and the exhibits.

Dated, New York, N.Y., March 5, 1947.

Respectfully submitted, (S.) Peter B. Olney, Referee.

Hearing on above certificate will be on the bankruptcy motion calendar in the United States Court House, Foley Square, New York City, on Wednesday, March 12, 1947, at 10:30 A. M. Notice thereof given to the attorneys.

(S.) Peter B. Olney.

[fol. 28] IN UNITED STATES DISTRICT COURT

MEMORANDUM DECISION OF REFEREE

Referee's Memorandum on Question of Allowing Interest on Taxes Due State of New York and the United States Until Date of Payment.

Various decisions by the United States Courts have held that interest should be paid until date of payment upon tax claims allowed in bankrupt estates.

See

United States vs. Childs, 266 U. S. 304.
Davie vs. Green, C. C. A. 1, 133 Fed. 2nd, 451.
Re: Semon D. C. Conn. 11 Fed. Supp. 18, modified on other grounds (C. C. A. 2nd) 80 Fed. 2nd, 81,
re: Summers (Referee Friebolin, No. Dist. Ohio, Eastern Division) 45 A. B. R. N. S. 123, 128-9.
Collier on Bankruptcy, 14th Edit. Vol. 3, p. 1841, *et. sec.*

Trustee relies upon a strong dicta in Hammer vs. Tuffy, (C. C. A. 2nd) 143 Fed. 2nd, 447, 449.

However, as the decision in Hammer vs. Tuffy (as distinguished from the dicta) had nothing to do with interest on taxes, I feel as did Referee Friebolin, *re* Summers *supra*, that I am bound by the decisions in point "until some decision is recorded directly upon this point by the Supreme Court or a Court whose decision is 'binding upon me'".

Hence my Conclusions of Law in my Findings dated the same date as this memorandum.

Dated, New York, January 24th, 1947.

Peter B. Olney, Referee.

[fol. 29] IN UNITED STATES DISTRICT COURT

REFEREE'S FINDINGS OF FACT ON OBJECTIONS TO CLAIM OF THE STATE OF NEW YORK

1. There is no dispute as to the amount of the tax. The only ground of objection is that interest should not be allowed up to the date of payment.

CONCLUSIONS OF LAW

First. Trustee's objection to allowance of interest on amount of claim as allowed up to date of payment is overruled for the reasons stated in a memordandum bearing the same date as these Findings.

Settle order on notice.

Dated, New York, January 24th, 1947.

Peter B. Olney, Referee.

[fol. 30] IN UNITED STATES DISTRICT COURT

REFEREE'S FINDINGS OF FACT AND CONCLUSIONS OF LAW ON OBJECTIONS TO CLAIM OF THE UNITED STATES

I, Peter B. Olney, the Referee in charge of the above entitled matter, do hereby make my Findings of Fact and Conclusions of Law on the objections filed by the trustee herein to the claim filed by the Collector of Internal Revenue.

FINDINGS OF FACT

1. The trustee has objected to the claim of the Collector of Internal Revenue in the sum of $8,059.49 on three grounds: (a) To the items of $112.23 and interest thereon of $3.68 under SS Title IX, Balance of year 1938. (This objection is conceded to be valid, S. M. 42); (b) To Income Tax items

as follows: Additional tax for fiscal year ending 1(31)38, $3537.66, interest thereon $469.20, and excess profit tax for same period $310.33 and interest thereon $41.16; (c) To the allowance of interest for any period subsequent to the date of the filing of the petition herein, December 20th, 1939.

* * * * * * *

Conclusions of Law

* * * * * * *

Fourth. Trustee's objections to allowance of interest on amount of claim as allowed till date of payment, is overruled for the reasons stated in a memorandum bearing the same date as these Findings.

Settle order on notice.

[fol. 21] In the District Court of the United States

[Title omitted]

Minutes of Hearing Before Referee

Before: Hon. Peter B. Olney, Referee.

Hearings on Objections to Claims of United States Government and State of New York

(July 8 and 22, 1946)

Motion of Trustee to Re-Open Hearing re Interest on Tax Claims

(February 13, 1947)

* *

[fol. 32] IN UNITED STATES DISTRICT COURT

[Title omitted]

HEARING OF JULY 8, 1946

New York, July 8, 1946, 3:45 o'clock P. M.

Before: Hon. Peter B. Olney, Referee.

Hearing on Objections to Claims of United States Government and State of New York

Proceeded Pursuant to Notice

* * * * * * *

IN UNITED STATES DISTRICT COURT

[Title omitted]

HEARING OF JULY 22, 1946

New York, July 22, 1946, 2:00 o'clock P. M.

Before: Hon. Peter B. Olney, Referee.

Adjourned Hearing on Objections to Claims of United States Government and State of New York

Proceeded Pursuant to Adjournment

* * * * * * *

[fol. 33] IN UNITED STATES DISTRICT COURT

[Title omitted]

HEARING OF FEBRUARY 13, 1947

New York, February 13, 1947,
3:45 O'clock P. M.

Before Hon. Peter B. Olney, Referee

MOTION OF TRUSTEE TO REOPEN HEARING RE INTEREST ON TAX CLAIMS, PROCEEDED PURSUANT TO NOTICE

Appearances:

Messrs. Parker, Chapin & Flattau and Messrs. Glass & Lynch, Co-Attorneys for Leonard H. Carter, Trustee, by Sidney W. Cable, Esq., of Counsel.

Hon. Nathaniel L. Goldstein, Attorney General of the State of New York, representing State Tax Commission, Claimant, by Anthony P. Ludden, Esq., Assistant Attorney General;

Hon. John F. X. McGohey, United States Attorney representing Collector of Internal Revenue, Claimant, by Frank J. Stella, Esq., Assistant United States Attorney.

Mr. Cable: This is a motion of the trustee to re-open the hearing upon the objections to tax claims and the payment of interest on the tax claims to the date of payment.

[fol. 34] The parties have agreed that an order may be entered on consent.

(There ensued informal discussion and oral argument.)

The Referee: I will grant this motion to re-open the proceedings and consider that Mr. Cable on behalf of the trustee is making an offer of proof of the facts set forth in paragraph 7 of his petition.

Mr. Cable: Subdivisions "(a)" to "(r)", inclusive. The point I make, sir, is that I should like Mrs. Mitchell to copy into the record those subdivisions in order that we will have a transcript to send up with your certificate.

The Referee: All right.

(The subdivisions are as follows:

"(a) An involuntary petition in bankruptcy was filed herein December 20, 1939.

"(b) A turnover proceeding was commenced by the Trustee against Abraham Jeskowitz, President of the bankrupt by petition verified October 25, 1940 and that hearings in said proceeding were held from January 27, 1941 to May 6, 1942.

"(c) That a turnover order of the Referee in Bankruptcy was entered on February 23, 1943.

"(d) That the turnover order was affirmed upon appeal by the United States District Court for the Southern District of New York on May 6, 1943.

"(e) That the turnover order was affirmed by the Circuit Court of Appeals, Second Circuit on July 21, 1944.

"(f) That the petition of Abraham Jeskowitz for a writ of certiorari was denied by the Supreme Court

of the United States on December 11, 1944, and his petition for rehearing was denied on January 2, 1945.

[fol. 35] "(g) That the petition of Abraham Jeskowitz to reopen the turnover proceeding before the Referee was denied by order of the Referee dated November 29, 1944.

"(h) That the motion of Abraham Jeskowitz to the Circuit Court of Appeals for leave to petition the Referee to reopen the turnover proceeding was denied by order of the Circuit Court of Appeals, dated February 9, 1945 and the motion for reargument thereon was denied by an order dated March 9, 1945.

"(i) The Supreme Court denied the petition of Abraham Jeskowitz for a writ of certiorari to review that order on May 21, 1945.

"(j) That thereafter an order to punish Abraham Jeskowitz was made by the District Court for the Southern District of New York on September 10, 1945.

"(k) The order punishing Abraham Jeskowitz for contempt was affirmed by the Circuit Court of Appeals, Second Circuit on February 14, 1946.

"(l) That petition of Abraham Jeskowitz for a writ of certiorari was denied by the Supreme Court of the United States on May 6, 1946.

"(m) That thereafter, Abraham Jeskowitz, pursuant to the contempt order dated September 10, 1945 was incarcerated in the Federal House of Detention.

"(n) That an offer of settlement of all claims of the Trustee against Abraham Jeskowitz was accepted at a special meeting of creditors held on July 8, 1946 and the Trustee was authorized to accept said settlement and release Abraham Jeskowitz of all claims by the order dated July 15, 1946.

"(o) That the total amount of allowed claims filed in this proceeding is $89,128.76.

[fol. 36] "(p) That the claims of the United States of America aggregate $9,865.35, the claims of the People of the State of New York aggregate $1,660.92, and that both aggregate $11,526.27.

"(q) That the amount of interest, at the rate of six per centum (6%) per annum, on $11,526.27 from December 29, 1939 to the date of this petition is $4,930.08.

"(r) That the assets of the estate prior to receipt of the amount of the settlement payment of $30,000 were $19,888.11 in cash on deposit in two banks and a small lot of merchandise which the Trustee has been unable to get any bids upon.")

Mr. Ludden: I want to put in an objection by the Attorney General for the State Tax Commission by the Attorney General for the State Department of Labor, Division of Placement and Unemployment Insurance. The State objects on the ground that the proof that is offered is immaterial and irrelevant, it is tantamount to a new trial; that this motion should be denied for the reason that the Referee has made his determination and his findings from the evidence submitted at the trial and that the only remedy the attorney for the trustee has is an appeal from the evidence adduced at the time of the trial. Upon that ground I object to the receiving of this evidence.

The Referee: All right.

Mr. Stella: The United States Government objects on the ground that the evidence and proof submitted by the trustee is immaterial and irrelevant. There is a question of law only involved.

The Referee: Now, Mr. Cable, you can refer to those cases that you had in mind.

[fol. 37] Mr. Cable: Your Honor will hear argument briefly on this point: the question of the priority of these tax claims and interest thereon governed by Section 64 of the Bankruptcy Act which contains only the words "paid in full".

Section 57k of the Bankruptcy Act requires that claims which have been allowed may be re-considered for cause and re-allowed or rejected in whole or in part according to the equities of the case.

The Bankruptcy Court under Section 2a of the Bankruptcy Act is vested with jurisdiction at law and in equity. However, in Continental Illinois National Bank & Trust vs. Chicago, Rock Island & Pacific Railway Company, 294 U. S. 648, the Supreme Court said (p. 675):

"The courts of bankruptcy are essentially courts of equity and that the words 'at law' probably having been

inserted only with regard to clause 4 of Section 2 of the Act which confers authority to arraign, try and punish bankrupts and others."

In a recent case entitled Vanston Bondholders' Protective Committee vs. Green, 91 Law Edition, 175, the Supreme Court held, after reviewing a number of these prior cases on the allowance of interest, that it was manifest that the touchstone of each decision on an allowance of interest in bankruptcy, receivership and reorganization has been a balance of equities between creditor and creditor or between creditors and the debtor.

Accordingly it is the contention of the trustee that in view of the language of 64a and the necessity of construing that language, and in view of the dictum of the C. C. A. in Hammer vs. Tuffy that the equities of the facts in the instant case are most relevant and material to a determination of the interest issue presented to this court. Conse- [fol. 38] quently the offer of proof should be accepted because each of the facts relates to an equitable consideration.

The Referee: The motion to re-open is granted.

The objection to the receipt of the proof offered is sustained for the reasons I stated in allowing the interest in my findings and memorandum. In none of the decisions relied upon by the taxing authorities was there any consideration given to the equities of the case. The question of interest in the decided cases has been passed upon heretofore purely as a matter of law and I deem that I am bound to follow those decisions on the present state of the decided decisions regardless of considerations of equity, no matter how persuasive arguments may be made in any one individual case upon such equitable ground.

Therefore, the objections as I have stated to the offer of proof and the facts set forth are sustained on the ground that such facts are immaterial and irrelevant. The decision is one made purely as a matter of law.

The bankruptcy courts always have been held to proceed largely on equitable principles but they are also courts at law and there has never been any proceeding that I know of which would in effect permit the court to act upon the so-called equitable principles solely and wholly in deciding matters that come before it for decision. The wording of statutes applicable and decisions thereunder must be taken

as precedents binding upon the lower court when matters come before it for decision.

So you may enter the appropriate order and have this part of the record.

(Thereupon, at 4:30 o'clock P. M., the matter was concluded.)

[fol. 39] IN UNITED STATES CIRCUIT COURT OF APPEALS, SECOND CIRCUIT

[Title omitted]

STIPULATION AS TO RECORD

It Is Hereby Stipulated and Agreed that the foregoing is a true and correct transcript of the record of the District Court in the above entitled matter, as agreed on by the parties.

Dated: New York, N. Y., January 21, 1948.

John F. X. McGohey, United States Attorney, by William M. Regan, Assistant United States Attorney; Nathaniel L. Goldstein, Attorney General of the State of New York, Attorney for Tax Claimant-Appellant, by Francis R. Curran, Assistant Attorney General; Parker, Chapin & Flattau, and Glass & Lynch, Attorneys for Trustee, by Sidney W. Cable.

[fol. 40] Clerk's Certificate to foregoing transcript omitted in printing.

[fol. 41] UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT, OCTOBER TERM, 1947

No. 195

(Argued March 8, 1948. Decided May 25, 1948.)

Docket No. 20909

LEONARD H. CARTER, Trustee of Union Fabrics, Inc., Bankrupt, Trustee-Appellee,

against

UNITED STATES OF AMERICA and STATE OF NEW YORK, Claimants-Appellants

Before Augustus N. Hand, Chase and Clark, Circuit Judges

Appeal from the United States District Court for the Southern District of New York

From an order of the District Court allowing interest on tax claims only to the date of the filing of the petition in bankruptcy, the United States and the State of New York appeal. Affirmed.

[fol. 42] John F. X. McGohey, United States Attorney, for United States of America, Claimant-Appellant; William M. Regan, Assistant United States Attorney, Counsel. Nathaniel L. Goldstein, Attorney General of the State of New York, for the State of New York, Claimant-Appellant; Wendell P. Brown, Solicitor General, and Francis R. Curran, Assistant Attorney General, Counsel.

Parker, Chapin & Flattau, and Glass & Lynch, Attorneys for Leonard H. Carter, Trustee-Appellee; Sydney W. Cable and Leslie Kirsch, Counsel.

Gerdes & Montgomery, Attorneys for New York Credit Men's Association, Amicus Curiae; W. Randolph Montgomery, Counsel.

AUGUSTUS N. HAND, Circuit Judge:

An involuntary petition in bankruptcy was filed against Union Fabrics, Inc., on December 20, 1939. The United States and the State of New York filed tax claims, asking for interest to the date of payment of the claims. The ref-

eree overruled the objections of the trustee to the payment of interest on these claims beyond the date of the filing of the petition in bankruptcy and allowed such interest. The referee thereafter reopened the proceeding for the purpose of hearing a further objection by the trustee, based upon certain alleged equitable considerations, but sustained objections to this evidence and made an order to that effect. Upon a petition for review, the district judge reversed the [fol. 43] orders allowing interest on the claims to the date of payment and sustaining objections to the trustee's offer of proof at the rehearing. He held that interest on the tax claims should be treated in the same manner as interest on other claims and not allowed beyond the date of the filing of the petition. In respect to the evidence offered to show a long delay in the administration of the estate, he regarded such equitable considerations, if pertinent to the determination, as sufficiently shown by the records of the court to augment other reasons for the denial of interest.

Judge Chase and I do not agree with the decision of the court below and think that interest on tax claims should be allowed to the date of their payment under the settled ruling of the federal courts prior to the enactment of the Chandler Act in 1938—a ruling which we do not regard as changed by anything in that Act. We have however decided to acquiesce in the contrary decision of this court on this question in *Saper* v. *City of New York*, F. 2d , decided May 25, 1948, which represents the view of the majority of the five judges who have been concerned in *Saper* v. *City of New York* and the case at bar with the issue here involved. Such a mode of dealing with the appeal before us will settle the law in this circuit as to the allowance of interest on tax claims unless the Supreme Court should hereafter reach a different conclusion. However, we feel it advisable to state in more detail our personal views, which are in accord with those of the First Circuit in *Davis* v. *Green*, 133 F. 2d 451.

It is not disputed that prior to the Chandler Act taxes bore interest down to the date of payment. This was decided under the provisions of Section 57-j of the Bankruptcy Act, by this court in *In re J. Menist*, 290 Fed. 947, and its determination as to the duration of the period for which interest was to run against bankrupt estates was [fol. 44] followed without discussion by the Supreme Court in *United States* v. *Childs*, 266 U.S. 304, though this very

question was raised in the arguments of counsel as reported. This rule remained unchanged prior to the passage of the Chandler Act in spite of the fact that in 1926 Section 64-a was amended to alter the absolute priority of taxes theretofore existing as compared with various other preferred claims. *Cf. Horn* v. *Boone County, Neb.*, 44 F. 2d 920 (C. C. A. 8); *In re Semon*, 11 F. Supp. 18 (D. C. D. Conn.), modified on other grounds, 80 F. 2d 81 (C. C. A. 2).

The Chandler Act amendments broadened Section 57(n), 11 U. S. C. A. § 93(n) to include "all claims of the United States" and required them to "be proved and filed in the manner" there provided; it also deleted Section 64(a), 11 U. S. C. A. § 104(a) requiring "the trustee to pay all taxes legally due and owing," but made no substantial change, if any, in the order of priorities. However only a minor verbal change, not pertinent to this appeal was made in Section 57(j), 11 U. S. C. A. § 93(j); indeed, that is the only change in this section since the Bankruptcy Act of 1898.

As we have already observed, prior to the Chandler Act the governments' claims to interest on taxes down to the date of payment was clear under a settled interpretation of the bankruptcy statute. We need not discuss the question whether governments do well to obtain any priorities over their citizens in payment of taxes, but priorities are given by statute and we think should not be modified by doubtful implication. We agree with Judge Woodbury's opinion in *Davie* v. *Green, supra*, that Congress would not have made such a far-reaching change as would result by reversing these prior interpretations without clear and specific enactment. As we have noted, only a minor alteration, irrelevant to this question, was made in Section 57-j by the Chandler Act, though the settled meaning of that section [fol. 45] must have been known to the Congressional Committees and many other fundamental changes were made when the bankruptcy law was being thoroughly revised by that Act. Furtner, if there had been any intention to alter the settled meaning of Section 57-j we think it would have been made evident by Congressional reports and debates, and the federal and state governments would not have been deprived of important priorities by means of a conjectural interpretation. The apparent absence of such evidence of legislative intention seems to us to argue for sustaining the prior judicial interpretation of the section rather than for any new meaning.

It is argued that since Section 57(n) requires that tax claims must be proved and filed like other claims and they are classified as debts in Section 64(a), they are subject to the ordinary rule applied to other claims that interest runs only to the date of the filing of the petition in bankruptcy. But the requirement for filing proofs of tax claims was primarily to facilitate the prompt and orderly administration of bankrupt estates and to enable the trustee safely to distribute assets with exact knowledge of all claims by preventing the representatives of governments from inordinately delaying presentation of their tax claims while interest thereon was still running. If is true that in *United States* v. *Roth*, 164 F. (2d) 575, we allowed a trustee in bankruptcy to set off against a tax claim a mutual indebtedness of the government. However, in that opinion we allowed the set-off which, as compared with an alternate judicial remedy of suit in a district court or the Court of Claims, was a procedural rather than a substantive matter and we regarded this result as indicated by the order of the Supreme Court prescribing forms for filing, which expressly referred to set-offs against the claimant. This decision does not lead to the conclusion that tax claims, though [fol. 46] they must now be proved as ordinary debts, should be reduced in the amount of their recovery from the estate by the elimination of interest subsequent to the date of the petition in bankruptcy. Indeed, we return to the conclusions of the First Circuit that so fundamental an alteration of settled rights as to the incidence of tax claims should have much stronger support than the analogy of the treatment of other claims.

As heretofore stated and in spite of the contra views expressed in this opinion the orders of the District Court are affirmed upon the authority of *Saper* v. *City of New York*, *supra*.

CLARK, Circuit Judge (concurring):

I concur in the result.

[fol. 47] UNITED STATES CIRCUIT COURT OF APPEALS, SECOND CIRCUIT

At a Stated Term of the United States Circuit Court of Appeals, in and for the Second Circuit, held at the United States Courthouse in the City of New York, on the 25th day of May one thousand nine hundred and forty-eight.

Present: Hon. Augustus N. Hand, Hon. Harrie B. Chase, Hon. Charles E. Clark, Circuit Judges.

In the Matter of UNION FABRICS, INC., Bankrupt, UNITED STATES and STATE OF NEW YORK, Claimants-Appellants.

Appeal from the District Court of the United States for the Southern District of New York

This cause came on to be heard on the transcript of record from the District Court of the United States for the Southern District of New York, and was argued by counsel.

On Consideration Whereof, it is now hereby ordered, adjudged, and decreed that the order of said District Court be and it hereby is affirmed upon the authority of Saper v. City of New York in accordance with the opinion of this court.

It is further ordered that a Mandate issue to the said District Court in accordance with this decree.

Alexander M. Bell, Clerk.

[fol. 48] [Endorsed:] United States Circuit Court of Appeals, Second Circuit. In the Matter of Union Fabrics, Inc., Bankrupt. 195. Judgment. United States Circuit Court of Appeals, Second Circuit. Filed May 25, 1948. Alexander M. Bell, Clerk.

[fol. 49] Clerk's Certificate to foregoing transcript omitted in printing.

[fol. 50] SUPREME COURT OF THE UNITED STATES, OCTOBER TERM, 1948

No. 200

ORDER ALLOWING CERTIORARI—Filed October 11, 1948

The petition herein for a writ of certiorari to the United States Court of Appeals for the Second Circuit is granted, and the case is assigned for hearing immediately following No. 168, City of New York vs. Saper, as Trustee.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

[fol. 51] SUPREME COURT OF THE UNITED STATES, OCTOBER TERM, 1948

No. 201

ORDER ALLOWING CERTIORARI—Filed October 11, 1948

The petition herein for a writ of certiorari to the United States Court of Appeals for the Second Circuit is granted, and the case is assigned for hearing immediately following Nos. 168 and 200.

And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

Endorsed on Cover: (File Nos. 53,202, 53,203. U. S. Circuit Court of Appeals, Second Circuit. Term No. 200. State of New York, Petitioner, vs. Leonard H. Carter, as Trustee in Bankruptcy. Term No. 201. The United States of America, Petitioner, vs. Leonard H. Carter, Trustee of Union Fabrics, Inc., Bankrupt. Petitions for writs of certiorari and exhibit thereto. Filed August 5, 1948. Term Nos. 200 O. T. 1948, 201 O. T. 1948.

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Supreme Court of the United States

No. 168 —OCTOBER TERM, 1948

THE CITY OF NEW YORK,
Petitioner,

against

LEWIS H. SAPER, as Trustee in Bankruptcy of SPOTLIGHT PRODUCTIONS, INC.,
Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

JOHN P. McGRATH,
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Municipal Building,
New York, N. Y.

ISAAC C. DONNER,
BERNARD H. SHERRIS,
Of Counsel.

JUDICIAL PRINTING CO., INC., 82 Beekman St., N. Y.—Beekman 3-0580—1948

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Supreme Court of the United States

No. —October Term, 1948

The City of New York,

Petitioner,

against

Lewis H. Saper, as Trustee in Bankruptcy of Spotlight Productions, Inc.,

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

To the Honorable The Supreme Court of the United States:

The petition of the City of New York respectfully shows:

1. Your petitioner is a municipal corporation organized and existing under and by virtue of the laws of the State of New York.

2. The respondent is the trustee in bankruptcy of Spotlight Productions, Inc., Bankrupt, in a bankruptcy proceeding pending in the United States District Court for the Southern District of New York, Docket No. 83203.

Statement of Matter Involved

3. In said bankruptcy proceeding your petitioner duly filed a claim as a priority claim for taxes due from the bankrupt for New York City sales taxes in the sum of $495.81, and for New York City business taxes in the sum

of $19.72, with interest upon the principal of said taxes at 1% per month up to the date of payment thereof (R. 14-17)* as provided by your petitioner's tax laws.

4. The respondent moved to expunge the said claim (R. 19-24). After a hearing before Honorable John E. Joyce, Referee in Bankruptcy, the motion was denied and the claim allowed in full as a priority claim under § 64a(4) of the National Bankruptcy Act, together with interest on the principal sum of such taxes to the date of payment at the rate of 1% per month (R. 73, 84-85).

5. Upon respondent's petition for review, the District Court dismissed the petition and affirmed the Referee's order in all respects (R. 106-111).

6. Upon appeal by the respondent to The United States Circuit Court of Appeals for the Second Circuit, that Court reversed the order of the District Court to the extent that that order allowed interest on your petitioner's tax claim beyond the date of filing of the petition in bankruptcy, January 5, 1944, and in all other respects affirmed the order of the District Court (R., p. 49).

7. The Circuit Court held that by virtue of amendments made by the Chandler Act (52 Stat. 840) to § 57n and § 64a of the National Bankruptcy Act, interest was allowable upon tax claims in bankruptcy proceedings only until the date of the filing of the petition in bankruptcy. Your petitioner seeks to have this Court review the decision of the Circuit Court on this point.

Jurisdiction and Timeliness

8. The petition is made under 28 U. S. C. A. § 347, subd. (a), and the Court has jurisdiction to grant the writ. *City of New York* v. *Feiring, Trustee in Bankruptcy,*

* References are to folios of the Record unless otherwise indicated.

313 U. S. 552 (1941); *City of New York v. Goldstein, Trustee in Bankruptcy*, 299 U. S. 522 (1937).

9. The decision of the Circuit Court of Appeals was handed down on May 25, 1948, and the order thereon was entered on the same day. This petition is, therefore, timely.

10. The record remains in the custody of the Clerk of the United States Circuit Court of Appeals for the Second Circuit. Issuance of the mandate was stayed by the Court pursuant to Rule 31 of that Court.

Statutes Involved

11. The New York City sales taxes here involved were imposed pursuant to the Administrative Code of the City of New York, Chapter 41, Title N, and the business taxes were imposed pursuant to the provisions of the Administrative Code of the City of New York, Chapter 41, Titles R and RR. Each of said Titles of the Administrative Code has a provision imposing penalties and interest in case of failure to file a return or to pay taxes due as required. The provision in Title N of Chapter 41 (sales tax) reads as follows (Adm. Code, § N41-17.0, subd. a):

> "*Penalties and interest.*—a. Any person failing to file a return or to pay or pay over any tax to the treasurer within the time required by this title shall be subject to a penalty of five percentum of the amount of tax due; plus interest at the rate of one percentum of such tax for each month of delay excepting the first month after such return was required to be filed or such tax became due; but the comptroller or as provided in section N41-13.0, the treasurer if satisfied that the delay was excusable, may remit all or any part of such penalty, but not interest at the rate of six per cent per year. Such penalties and interest shall be paid and dis-

posed of in the same manner as other revenues from this title. Unpaid penalties and interest may be enforced in the same manner as the tax imposed by this title."

The corresponding provision of Title R and Title RR of the Administrative Code (business tax) is practically identical. (See Adm. Code, § R41-14.0, subd. a and § RR41-14.0, subd. a.)

12. The provisions of the National Bankruptcy Act relied on and referred to in the opinion of the Court below, §§ 57j, 57n, 63a and 64a (11 U. S. C. A. §§ 93j, 93n, 103a and 104a, respectively), as they read both before and after the Chandler Act are set forth in Appendix A, *post*, pages 12-21.

Opinions Below

13. In addition to the opinions of the Circuit Court and the District Judge in this case, attention is also directed to the opinion of the Circuit Court in the case of *Carter, Trustee in Bankruptcy* v. *United States of America and State of New York*, —— F. (2d) ——, decided at the same time, which involved the same question as here presented. The opinion in the *Carter* case is set forth in full in Appendix B, *post*, pages 22-25.

(a) The District Court sustained the Referee's order which had allowed interest on petitioner's tax claim to the date of payment. On this point, the District Judge (Coxe, D. J.), stated in his opinion (R. 103-105) that such holding was in accord with the general rule laid down in *In re Meinst & Co.* 290 F. 947 (C. C. A. 2, 1923), modified on other grounds *sub nom. United States* v. *Childs*, 266 U. S. 304 (1924). He found no merit in the respondent's contention that the Chandler Act amendments to §§ 57n and 64a of the Bankruptcy Act had the effect of stopping interest on tax claims upon filing of the bankruptcy petition (R.

103), and found no clear evidence of a congressional intent to alter the general rule (R. 105). Concerning the amendment to § 57n he said (R. 103-104):

> "Sec. 57n as amended simply substitutes a statutory bar to the filing of governmental claims for a court made bar. It is designed, so far as relevant and tempered by the provision for extension, to subject such claims to the same requirements as to filing as other claims and to speed up closing of estates. Senate Report No. 1916 on H. R. 8046, 75th Cong. 3d Sess. (1938)."

He pointed out also that § 64a as amended provides, as did the former § 64b, that priority debts, which included taxes, should "be paid in full" before payment of dividends to creditors (R. 104), and that the provision of § 57j requiring the allowance of government debts with interest accrued thereon had not been changed (R. 105). He cited *Davie* v. *Green*, 133 F. (2d) 451 (C. C. A. 1, 1943) in support of his position.

(b) The Circuit Court (L. HAND, SWAN, CLARK, C. JJ.) reversed the District Court, holding in substance that the Chandler Act amendments to §§ 57n and 64a had the effect of placing tax claims on a par with other debts. In its opinion (R., pp. 42-49), the Court acknowledged that before the Chandler Act the general rule had been to allow interest upon tax claims at the statutory rate to the time of payment, citing *inter alia* its own decisions, *In re Menist & Co.*, *supra*, and *In re Semon*, 11 F. Supp. 18 (D. C. Conn., 1935) modified on other grounds 80 F. (2d) 81 (C. C. A. 2, 1935). The Court stated further, however, that § 64a and § 57n as amended by the Chandler Act treat tax claims the same as other debts and concluded that tax claims thereby became "provable debts" under § 63a, which allows interest only to the date of filing of petition (R., pp. 45-46). The Court said (R., p. 46):

"* * * Thus it is apparent that the Act, as it now stands, treats the tax claim as a debt and the United States as a creditor which, like other creditors, must make proof of claim on a form prescribed by the Supreme Court. This, then, took from tax claims their former favored position where no proof or other governmental action was necessary for their enforcement. Thenceforth they must be proved, or otherwise be barred, just like other debts of the bankrupt.

We see no reason to suppose that this did not place tax claims in the same situation as other debts with respect to interest also."

(c) *Carter, Trustee etc.* v. *United States, et al., supra,* involving the same question was decided at the same time as the instant case by a panel of Judges of the Circuit Court for the Second Circuit consisting of A. H. HAND, CHASE, CLARK, C. JJ. Of the Court as thus constituted, A. H. HAND and CHASE, C. JJ., in an opinion by the former, disagreed with the views of the Court in the present case, saying (Appendix B, *post*, at pp. 22-23):

"Judge Chase and I * * * think that interest on tax claims should be allowed to the date of their payment under the settled ruling of the federal courts prior to the enactment of the Chandler Act in 1938—a ruling which we do not regard as changed by anything in that Act. We have however, decided to acquiesce in the contrary decision of this court on this question in *Saper* v. *City of New York*, F. 2 , decided May 25, 1948, which represents the view of the majority of the five judges who have been concerned in *Saper* v. *City of New York* and the case at bar with the issue here involved. Such a mode of dealing with the appeal before us will settle the law in this circuit as to the allowance of interest on tax claims unless the Supreme Court should hereafter reach a different conclusion. However, we feel it advisable to state in more detail our personal views, which are in accord with those of the First Circuit in *Davie* v. *Green*, 153 F. 2d 451."

This opinion is set forth in full in Appendix B, *post*, pages 22-25. The views therein expressed are in substance the same as those expressed by COXE, D. J., in the case at bar.

Question Presented

14. The question presented is whether under the National Bankruptcy Act as amended by the Chandler Act, interest is payable on tax claims to the date of payment of such claims, as was the rule prior to the Chandler Act, or whether interest is to be allowed on tax claims only to the date of filing of the petition in bankruptcy.

15. Your petitioner contends that the Chandler Act amendments upon which the Court below relied did not in fact, and were not intended to, change the substantive rights of tax claimants or the status of tax claims in bankruptcy proceedings, or the rule with respect to the interest to be allowed on such tax claims for the following reasons: (a) Under the National Bankruptcy Act after the Chandler Act as before that Act, "taxes legally due and owing by the bankrupt" continued to be entitled to be paid in full in advance of payment of dividends to creditors, as a priority debt of substantially the same degree (§ 64a); continued to be non-dischargeable by bankruptcy proceedings (§ 17) and thereby retained their vitality under the laws pursuant to which imposed including accrual of interest for non-payment; and continued to be allowable with "such interest as may have accrued thereon according to law" (§ 57j). (b) The amendment to § 57n relied on by the Circuit Court effected, and was intended to effect, only a procedural change in respect of the proof and allowance of tax claims by substituting a prescribed statutory procedure and time limitation in place of the prior procedure which required this to be done by Court order.

Assignment of Errors

16. The petitioner submits that the Circuit Court erred: (a) in holding that the amendments made by the Chandler Act to § 57n and § 64a of the National Bankruptcy Act had the effect of altering the law with respect to the status of tax claims and the interest to be allowed on tax claims against bankrupts, and placing such claims in the same situation as ordinary debts with respect to interest; (b) in failing to hold that interest is allowable on your petitioner's tax claim to the date of payment thereof by the trustee in bankruptcy; (c) in reversing the decision of the District Court so far as it allowed interest on your petitioner's tax claim to the date of payment of said claim, and in allowing interest on the claim only to the date of the filing of the petition in bankruptcy.

Reasons for Allowance of the Writ

17. The decision of the Circuit Court herein is in conflict with the decision of the Circuit Court of Appeals for the First Circuit on the same point. See *Davie* v. *Green*, 133 F. (2d) 451 (1943).

18. There is a disagreement among the Judges within the Circuit Court of Appeals for the Second Circuit who have considered the question here presented in two cases which came before that Court. *Cf.* opinion in case at bar (R., pp. 42-49), with opinion in *Carter, Trustee, etc.* v. *United States et al., supra* (Appendix B, *post*, pp. 22-25).

19. The question is of considerable importance in the administration of bankrupt estates and until settled by this Court will tend to cause confusion and uncertainty in the administration of bankrupt estates. Moreover, as the Court below has said (R., p. 43), the question affects all tax claims

in bankruptcy, not merely those of the City of New York, but of the Federal government and of any State or subdivision thereof.

20. The decision below, it is respectfully submitted, contravenes the nearest applicable decisions of the Circuit Court of Appeals for the Second Circuit, as well as of this Court, rendered on the question prior to the enactment of the Chandler Act. See *In re Menist & Co., supra*, modified on other grounds *sub nom. United States* v. *Childs, supra; In re Semon, supra.*

21. The case represents an important question of federal bankruptcy law which has not been passed upon by this Court since the amendment of the National Bankruptcy Act by the Chandler Act, but which should be passed upon by this Court.

WHEREFORE, your petitioner prays that a writ of certiorari may be issued out of and under the seal of this Court directed to the United States Circuit Court of Appeals for the Second Circuit commanding the said Circuit Court to certify and send to this Court on a day certain therein to be designated a full and complete transcript of the record and all proceedings of the said Circuit Court of Appeals for the Second Circuit in this case, being No. 267 on its calendar for the October Term, 1947, to the end that the case may be reviewed and determined in this Court as provided in 28 U. S. C. A. § 347, and that the said final order of the said Circuit Court of Appeals for the Second Circuit in this case to the extent that it determines and directs the reversal of the order of the District Court herein so far as it allows interest on your petitioner's tax claim after the filing of the petition in bankruptcy on January 5, 1944 and directs that interest on your petitioner's tax claim be allowed only to the date of filing petition may be reviewed by this Court, and the said determination and order

of the Circuit Court of Appeals for the Second Circuit to the extent indicated may be reversed, and the determination of the District Court herein allowing interest on your petitioner's tax claim herein to the date of payment thereof after the filing of petition in bankruptcy may be reinstated, and a mandate be issued directing that your petitioner's claim be allowed with interest thereon to the date of payment thereof; and your petitioner prays for such other and further relief as to this Court shall seem just and equitable; and your petitioner will ever pray.

New York, N. Y
July 15, 1948

THE CITY OF NEW YORK,
Petitioner,

By JOHN P. McGRATH,
Corporation Counsel of the City of New York,
Municipal Building,
New York, N. Y.

ISAAC C. DONNER,
BERNARD H. SHERRIS,
of Counsel.

[APPENDICES FOLLOW]

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Appendix A

Pertinent Provisions of the National Bankruptcy Act

BEFORE THE CHANDLER ACT

Section 57 j

Debts owing to the United States, a State, a county, a district, or a municipality as a penalty or forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained by the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interest as may have accrued thereon according to law.

Section 57 n

Claims shall not be proved against a bankrupt estate subsequent to one year after the adjudication; or if they are liquidated by litigation and the final judgment therein is rendered within thirty days before or after the expiration of such time, then within sixty days after the rendition of such judgment: Provided, That the right of infants and insane persons without guardians without notice of the proceedings, may continue six months longer.

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Appendix A

Pertinent Provisions of the National Bankruptcy Act

As Amended by the Chandler Act

Section 57j

Debts owing to the United States or any State or subdivision thereof as a penalty or forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained by the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interest as may have accrued thereon according to law.

Section 57n

Except as otherwise provided in this title, all claims provable under this title, including all claims of the United States and of any State or subdivision thereof, shall be proved and filed in the manner provided in this section. Claims which are not filed within six months after the first date set for the first meeting of creditors shall not be allowed: *Provided, however,* That the court may, upon application before the expiration of such period and for cause shown, grant a reasonable fixed extension of time for the filing of claims by the United States or any State or subdivision thereof: *Provided further,* That, except in proceedings under chapters 10, 11, 12, and 13 of this title, the right of infants and insane persons without guardians, without notice of the bankruptcy proceedings, may continue six months longer: *And provided further,* That a claim arising in favor of a person by reason of the recovery by the trustee from such person of money or property, or the avoidance by the trustee of a lien held by such person, may be filed within thirty days from the date of such

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Appendix A

Pertinent Provisions of the National Bankruptcy Act

Before the Chandler Act

Section 63a

Debts of the bankrupt may be proved and allowed against his estate which are (1) a fixed liability, as evidenced by a judgment or an instrument in writing, absolutely owing at the time of the filing of the petition against him, whether then payable or not, with any interest thereon which would have been recoverable at that date or with a rebate of interest upon such as were not then payable and did not bear interest; (2) due as costs taxable against an involuntary bankrupt who was at the time of the filing of the petition against him plaintiff in a cause of action which would pass to the trustee and which the trustee declines to prosecute after notice; (3) founded upon a claim for taxable costs incurred in good faith by a creditor before the filing of a petition in an action to recover a provable debt; (4) founded upon an open account, or upon

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Appendix A

Pertinent Provisions of the National Bankruptcy Act

As Amended by the Chandler Act

Section 57n (Continued)

recovery or avoidance, but if the recovery is by way of a proceeding in which a final judgment has been entered against such person, the claim shall not be allowed if the money is not paid or the property is not delivered to the trustee within thirty days from the date of the rendering of such final judgment, or within such further time as the court may allow. When in any case all claims which have been duly allowed have been paid in full, claims not filed within the time hereinabove prescribed may nevertheless be filed within such time as the court may fix or for cause shown extend and, if duly proved, shall be allowed against any surplus remaining in such case.

Section 63a

Debts of the bankrupt may be proved and allowed against his estate which are founded upon (1) a fixed liability, as evidenced by a judgment or an instrument in writing, absolutely owing at the time of the filing of the petition by or against him, whether then payable or not, with any interest thereon which would have been recoverable at that date or with a rebate of interest upon such as were not then payable and did not bear interest; (2) costs taxable against a bankrupt who was at the time of the filing of the petition by or against him plaintiff in a cause of action which would pass to the trustee and which the trustee declines to prosecute after notice; (3) a claim for taxable costs incurred in good faith by a creditor before the filing of the petition in an action to recover a probable

Continued on page 17

Appendix A

Pertinent Provisions of the National Bankruptcy Act

Before the Chandler Act

Section 63a (Continued)

a contract, express or implied; (5) founded upon provable debts reduced to judgments after the filing of the petition and before the consideration of the bankrupt's application for a discharge, less costs incurred and interest accrued after the filing of the petition and up to the time of the entry of such judgments; (6) founded upon an award of an industrial accident commission, or other commission, body or officer, of any State or Territory having power or jurisdiction to make awards as workmen's compensation in case of injury or death for injury prior to adjudication; (6½) the amount of any damages, as evidenced by a judgment of a court of competent jurisdiction, in any action for negligence instituted prior to adjudication of defendant in such action in bankruptcy and pending at the time of the filing of petition in bankruptcy, whether voluntary or involuntary; *Provided,* That the provisions of this clause (6½) shall apply to estates that were pending on June 7, 1934, and are in process of settlement; and (7) claims for damages respecting executory contracts including future rents whether the bankrupt be an individual or a corporation, but the claim of a landlord for injury resulting from the rejection by the trustee of an unexpired lease of real estate or for damages or indemnity under a covenant contained in such lease shall in no event be allowed in an amount exceeding the rent reserved by the lease, without acceleration, for the year next succeeding the date of the surrender of the premises plus an amount equal to the unpaid rent accrued up to said date: *Provided,* That the court shall scrutinize the circumstances of an assign-

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Appendix A

Pertinent Provisions of the National Bankruptcy Act

As Amended by the Chandler Act

Section 63a (Continued)

debt; (4) an open account, or a contract express or implied; (5) provable debts reduced to judgments after the filing of the petition and before the consideration of the bankrupt's application for a discharge, less costs incurred and interest accrued after the filing of the petition and up to the time of the entry of such judgments; (6) an award of an industrial-accident commission, body, or officer of any State having jurisdiction to make awards of workmen's compensation in case of injury or death from injury, if such injury occurred prior to adjudication; (7) the right to recover damages in any action for negligence instituted prior to and pending at the time of the filing of the petition in bankruptcy; (8) contingent debts and contingent contractual liabilities; or (9) claims for anticipatory breach of contracts, executory in whole or in part, including unexpired leases of real or personal property: *Provided, however,* That the claim of a landlord for damages for injury resulting from the rejection of an unexpired lease of real estate or for damages or indemnity under a covenant contained in such lease shall in no event be allowed in an amount exceeding the rent reserved by the lease, without acceleration, for the year next succeeding the date of the surrender of the premises to the landlord or the date of reentry of the landlord, whichever first occurs, whether before or after bankruptcy, plus an amount equal to the unpaid rent accrued, without acceleration, up to such date: *And provided further,* That in the case of an assignment of any such claim for damages, the court shall, in determining the amount thereof, examine the circumstances of

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Pertinent Provisions of the National Bankruptcy Act

BEFORE THE CHANDLER ACT

Section 63a (Continued)

ment of future rent claims and the amount of the consideration paid for such assignment in determining the amount of damages allowed assignee hereunder: *Provided further,* That the provisions of this clause (7) shall apply to estates pending on June 7, 1934, in which the time for filing such claims has not expired.

Sections 64a and 64b

(a) The court shall order the trustee to pay all taxes legally due and owing by the bankrupt to the United States, State, county, district, or municipality, in the order of priority as set forth in paragraph (b) hereof: *Provided,* That no order shall be made for the payment of a tax assessed against real estate of a bankrupt in excess of the value of the interest of the bankrupt estate therein as determined by the court. Upon filing the receipts of the proper public officers for such payments the trustee shall be credited with the amounts thereof, and in case any question arises as to the amount or legality of any such tax the same shall be heard and determined by the court.

(b) The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment shall be (1) the actual and necessary cost of preserving the estate subsequent to filing the petition; (2) the filing fees paid by creditors in involuntary cases, and, where property of the bankrupt, transferred or concealed by him either before or after the filing of the petition, shall have been recovered

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Section 63a (Continued)

the assignment and the consideration paid or to be paid therefor, and may allow the claim of the assignee in such amount, subject to the provisions of the foregoing proviso of this clause (9), as will be fair and equitable.

Section 64a

The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be (1) the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition; the fees for the referees' salary fund and for the referees' expense fund; the filing fees paid by creditors in involuntary cases; where property of the bankrupt, transferred or concealed by him either before or after the filing of the petition, shall have been recovered for the benefit of the estate of the bankrupt by the efforts and at the cost and expense of one or more creditors, the reasonable costs and expenses of such recovery; the costs and expenses of administration, including the trustee's expenses in opposing the bankrupt's discharge, the fees and mileage payable to witnesses as now or hereafter provided by the laws of the United States, and one reasonable attorney's fee, for the professional services actually rendered, irrespective of the number of attorneys employed, to the petitioning creditors in involuntary cases and to the bankrupt in voluntary and involuntary cases, as the court may allow; (2) wages, not to exceed $600 to each

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BEFORE THE CHANDLER ACT

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for the benefit of the estate of the bankrupt by the efforts and at the expense of one or more creditors, the reasonable expense of such recovery; (3) the cost of administration, including the fees and mileage payable to witnesses as now or hereafter provided by the laws of the United States, and one reasonable attorney's fee, for the professional services actually rendered, irrespective of the number of attorneys employed, to the petitioning creditors in involuntary cases while performing the duties herein prescribed, and to the bankrupt in voluntary and involuntary cases, as the court may allow; (4) where the confirmation of composition terms has been refused or set aside upon the objection and through the efforts and at the expense of one or more creditors, in the discretion of the court, the reasonable expenses of such creditors in opposing such composition; (5) wages due to workmen, clerks, traveling or city salesmen, or servants, which have been earned within three months before the date of the commencement of the proceeding, not to exceed $600 to each claimant; (6) taxes payable under paragraph (a) hereof and (7) debts owing to any person who by the laws of the States or the United States is entitled to priority: *Provided*, That the term "person" as used in this section shall include corporations, the United States and the several States and Territories of the United States.

Appendix A

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As Amended by the Chandler Act

Section 64a (Continued)

claimant, which have been earned within three months before the date of the commencement of the proceeding, due to workmen, servants, clerks, or traveling or city salesmen on salary or commission basis, whole or part time, whether or not selling exclusively for the bankrupt; (3) where the confirmation of an arrangement or wage-earner plan or the bankrupt's discharge has been refused, revoked, or set aside upon the objection and through the efforts and at the cost and expense of one or more creditors, or, where through the efforts and at the cost and expense of one or more creditors, evidence shall have been adduced resulting in the conviction of any person of an offense under this title, the reasonable costs and expenses of such creditors in obtaining such refusal, revocation, or setting aside, or in adducing such evidence; (4) taxes legally due and owing by the bankrupt to the United States or any State or any subdivision thereof; *Provided*, That no order shall be made for the payment of a tax assessed against any property of the bankrupt in excess of the value of the interest of the bankrupt estate therein as determined by the court: *And provided further*, That, in case any question arises as to the amount or legality of any taxes, such question shall be heard and determined by the court; and (5) debts owing to any person, including the United States, who by the laws of the United States is entitled to priority, and rent owing to a landlord who is entitled to priority by applicable State law: *Provided, however*, That such priority for rent to a landlord shall be restricted to the rent which is legally due and owing for the actual use and occupancy of the premises affected, and which accrued within three months before the date of bankruptcy.

Appendix B

Carter, Trustee, etc. *v.* United States *et al.*

Opinion of the Circuit Court of Appeals for the Second Circuit

AUGUSTUS N. HAND, *Circuit Judge*:

An involuntary petition in bankruptcy was filed against Union Fabrics, Inc., on December 20, 1939. The United States and the State of New York filed tax claims, asking for interest to the date of payment of the claims. The referee overruled the objections of the trustee to the payment of interest on these claims beyond the date of the filing of the petition in bankruptcy and allowed such interest. The referee thereafter reopened the proceeding for the purpose of hearing a further objection by the trustee, based upon certain alleged equitable considerations, but sustained objections to this evidence and made an order to that effect. Upon a petition for review, the district judge reversed the orders allowing interest on the claims to the date of payment, and sustaining objections to the trustee's offer of proof at the rehearing. He held that interest on the tax claims should be treated in the same manner as interest on other claims and not allowed beyond the date of the filing of the petition. In respect to the evidence offered to show a long delay in the administration of the estate, he regarded such equitable considerations, if pertinent to the determination, as sufficiently shown by the records of the court to augment other reasons for the denial of interest.

Judge Chase and I do not agree with the decision of the court below and think that interest on tax claims should be allowed to the date of their payment under the settled ruling of the federal courts prior to the enactment of the Chandler Act in 1938—a ruling which we do not regard as changed by anything in that Act. We have however decided

to acquiesce in the contrary decision of this court on this question in *Saper* v. *City of New York*, F. 2d , decided May 25, 1948, which represents the view of the majority of the five judges who have been concerned in *Saper* v. *City of New York* and the case at bar with the issue here involved. Such a mode of dealing with the appeal before us will settle the law in this circuit as to the allowance of interest on tax claims unless the Supreme Court should hereafter reach a different conclusion. However, we feel it advisable to state in more detail our personal views, which are in accord with those of the First Circuit in *Davie* v. *Green*, 133 F. 2d 451.

It is not disputed that prior to the Chandler Act taxes bore interest down to the date of payment. This was decided under the provisions of Section 57-j of the Bankruptcy Act, by this court in *In re J. Menist*, 290 Fed. 947, and its determination as to the duration of the period for which interest was to run against bankrupt estates was followed without discussion by the Supreme Court in *United States* v. *Childs*, 266 U. S. 304, though this very question was raised in the arguments of counsel as reported. This rule remained unchanged prior to the passage of the Chandler Act in spite of the fact that in 1926 Section 64-a was amended to alter the absolute priority of taxes theretofore existing as compared with various other preferred claims. *Cf. Horn* v. *Boone County, Neb.*, 44 F. 2d 920 (C. C. A. 8); *In re Semon*, 11 F. Supp. 18 (D. C. D. Conn.), modified on other grounds, 80 F. 2d 81 (C. C. A. 2).

The Chandler Act amendments broadened Section 57(n), 11 U. S. C. A. § 93(n) to include "all claims of the United States" and required them to "be proved and filed in the manner" there provided; it also deleted Section 64(a), 11 U. S. C. A. § 104(a) requiring "the trustee to pay all taxes legally due and owing," but made no substantial change; if

any, in the order of priorities. However only a minor verbal change, not pertinent to this appeal was made in Section 57(j), 11 U. S. C. A. § 93(j); indeed, that is the only change in this section since the Bankruptcy Act of 1898.

As we have already observed, prior to the Chandler Act the governments' claims to interest on taxes down to the date of payment was clear under a settled interpretation of the bankruptcy statute. We need not discuss the question whether governments do well to obtain any priorities over their citizens in payment of taxes, but priorities are given by statute and we think should not be modified by doubtful implication. We agree with Judge Woodbury's opinion in *Davie* v. *Green*, *supra*, that Congress would not have made such a far-reaching change as would result by reversing these prior interpretations without clear and specific enactment. As we have noted, only a minor alteration, irrelevant to this question, was made in Section 57-j by the Chandler Act, though the settled meaning of that section must have been known to the Congressional Committees and many other fundamental changes were made when the bankruptcy law was being thoroughly revised by that Act. Further, if there had been any intention to alter the settled meaning of Section 57-j we think it would have been made evident by Congressional reports and debates, and the federal and state governments would not have been deprived of important priorities by means of a conjectural interpretation. The apparent absence of such evidence of legislative intention seems to us to argue for sustaining the prior judicial interpretation of the section rather than for any new meaning.

It is argued that since Section 57(n) requires that tax claims must be proved and filed like other claims and they are classified as debts in Section 64(a), they are subject to the ordinary rule applied to other claims that in-

terest runs only to the date of the filing of the petition in bankruptcy. But the requirement for filing proofs of tax claims was primarily to facilitate the prompt and orderly administration of bankrupt estates and to enable the trustee safely to distribute assets with exact knowledge of all claims by preventing the representatives of governments from inordinately delaying presentation of their tax claims while interest thereon was still running. It is true that in *United States* v. *Roth*, 164 F. (2d) 575, we allowed a trustee in bankruptcy to set off against a tax claim a mutual indebtedness of the government. However, in that opinion we allowed the set-off which, as compared with an alternate judicial remedy of suit in a district court or the Court of Claims, we a procedural rather than a substantive matter, and we regarded this result as indicated by the order of the Supreme Court prescribing forms of filing, which expressly referred to set-offs against the claimant. This decision does not lead to the conclusion that tax claims, though they must now be proved as ordinary debts, should be reduced in the amount of their recovery from the estate by the elimination of interest subsequent to the date of the petition in bankruptcy. Indeed, we return to the conclusions of the First Circuit that so fundamental an alteration of settled rights as to the incidence of tax claims should have much stronger support than the analogy of the treatment of other claims.

As heretofore stated and in spite of the contra views expressed in this opinion the orders of the District Court are affirmed upon the authority of *Super* v. *City of New York*, *supra*.

CLARK, *Circuit Judge* (concurring): I concur in the result.

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Supreme Court of the United States

OCTOBER TERM, 1948

No. 168

THE CITY OF NEW YORK,

Petitioner,

against

LEWIS H. SAPER, Trustee in Bankruptcy of SPOTLIGHT PRODUCTIONS, INC.

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR PETITIONER

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Supreme Court of the United States

OCTOBER TERM, 1948

No. 168

THE CITY OF NEW YORK,

Petitioner,

v.

LEWIS H. SAPER, AS TRUSTEE IN BANKRUPTCY OF SPOTLIGHT PRODUCTIONS, INC.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR PETITIONER

A writ of certiorari was granted by this Court on October 11, 1948 (R. 40), to review an order (R. 38) of the United States Circuit Court of Appeals for the Second Circuit, affirming in part and reversing in part an order in bankruptcy (R. 28-29) made by the United States District Court for the Southern District of New York (COXE, J.), which allowed the claim of the petitioner against the trustee in bankruptcy for sales taxes and business taxes due the petitioner in the respective sums of $495.61 and $19.72, and allowed interest on such claims until the date of payment. The Circuit Court of Appeals' order affirmed the allowance of the petitioner's claim in the sums speci-

fied but provided that interest should run only until January 5, 1944, the date of the filing of the petition in bankruptcy.

The sole issue presented is whether interest on the petitioner's claim for taxes due from the bankrupt is to be allowed to the date of payment or only until the date of the filing of the petition in bankruptcy.

Opinions Below

The opinion of the District Court is reported in 75 Fed. Supp. 458.

The opinion of the Circuit Court of Appeals is reported in 168 Fed. (2nd) 268.

Grounds of Jurisdiction

The jurisdiction of this Court is invoked under Judicial Code, §240, 28 U.S.C.A. §347, subd. a. The order of the Circuit Court of Appeals was entered May 27, 1948. The petition for a writ of certiorari was filed on July 21, 1948 and was granted on October 11, 1948.

Statement of the Case

(1)

The petition in bankruptcy was filed January 5, 1944 (R. 32). On May 17, 1944 the petitioner, the City of New York, filed a proof of claim for $750 for sales taxes for the period from October 21, 1934 to January 5, 1944, and for $250 for business taxes from 1933 to 1943 (R. 2). The trustee objected and moved before the Referee for

an order expunging the claim (R. 5). On July 18, 1947 the City filed an amended proof of claim for sales taxes and business taxes for the period from November 1, 1940 to May 30, 1942 in the sums of $495.61 and $19.72, respectively, as principal, and $341.97 and $13.13, respectively, as interest at the statutory rate of 1% per month (R. 3-5).

Hearings were held before the Referee at which it appeared that no sales tax returns or business tax returns for the period November 1, 1940 to May 30, 1942 had been filed by the bankrupt (R. 18). Joseph Schlissel, an accountant employed by the petitioner, examined the records of the bankrupt and gathered together the figures upon which the petitioner's amended claim was based (R. 11). He testified (R. 12-16) and the Referee found (R. 19-20) that on the basis of sales made during the period involved $495.61 was due for sales taxes and $19.72 for business taxes. The Referee allowed those two amounts together with interest at the statutory rate of 1% per month until paid (R. 20, 23).

(2)

Upon review, the District Court (COXE, J.) affirmed the order of the Referee. In his opinion (R. 26-27) the District Judge stated that the petitioner was entitled to interest on its claim to the date of payment, citing *In Re J. Menist & Co.*, 290 Fed. 947 (C.C.A. 2, 1923), modified on other grounds *sub. nom. United States v. Childs*, 266 U. S. 304 (1924). The Court held that the rule had not been changed by the 1938 amendments to the Bankruptcy Act and cited *Davies v. Green*, 133 Fed. (2nd) 451 (C.C.A. 1, 1943).

The Circuit Court of Appeals reversed the order of the District Court in so far as it allowed interest on the City's claim to the date of payment. The opinion by Judge CLARK (R. 31-38) held that the 1938 amendments to the Bankruptcy Act had brought tax claims within the provisions of §63a and thereby placed them on a parity with ordinary claims so far as interest was concerned, and that interest did not accrue on any claims during the period of bankruptcy administration. Accordingly, the Court allowed interest on the City's claim only until January 5, 1944, the date of the filing of the petition in bankruptcy.

Specification of Errors to be Urged

We contend that the Circuit Court of Appeals erred in allowing interest on the City's claim only until the date of the filing of the petition in bankruptcy. Such interest should have been allowed to the date of payment.

Summary of Argument

Prior to the enactment of the Chandler Act in 1938 (52 Stat. 840), the decisions of this Court had settled the law to the effect that interest on a tax claim in bankruptcy runs until the date of payment of the claim. We shall analyze in our argument all of the changes as to tax claims made by the Chandler Act, and shall urge that they fail to show any intent to change the law that interest on tax claims runs until the date of payment but, on the contrary, indicate that Congress intended to leave that law unchanged.

The Chandler Act reenacted with only a minor change not here relevant §57j of the Bankruptcy Act providing for the payment of interest on tax claims. It thereby evidenced an intent that the rule as to the running of interest on tax claims to the date of payment should remain unchanged.

The Chandler Act also; (1) amended §57n of the Bankruptcy Act so as to require that tax claims be filed; (2) eliminated the provision in old §64a requiring the Court to order that tax claims be paid since that provision was no longer necessary because tax claims had to be filed under the amendment to §57n; (3) reenacted §64a leaving substantially unchanged the order of priority payments with respect to tax claims; and (4) reenacted §17 providing that tax claims are not dischargeable in bankruptcy if unpaid.

The change in §57n was designed to facilitate the administration of bankrupt estates and eliminate the necessity of the trustee obtaining bar orders as to tax claims. The change in §64a was an incident of the change in §57n. Those changes were of an administrative character and do not indicate an intent to change the rule that interest on tax claims runs until the date of payment. This is particularly true when the changes in §57n and old §64a are coupled with the provisions of the Chandler Act leaving substantially unchanged the order of priority payments with respect to tax claims (new §64a), and reenacting without material change §§57j and 17.

ARGUMENT

Tax claims in bankruptcy bear interest to the date of payment. The Chandler Act, so far as it related to tax claims, facilitated the administration of bankrupt estates by requiring tax claims to be filed and made certain other minor changes, but did not change the established rule that interest on taxes runs to the date of payment.

(1)

Prior to the passage of the Chandler Act (52 Stat. 840) in 1938, the rule was well established that by virtue of the provisions of §57j tax claims in bankruptcy bore interest to the date of payment:

Meilink, Trustee v. *Unemployment Reserves Commission of California,* 314 U. S. 564 (1941);
United States v. *Childs,* 266 U. S. 304 (1924); modifying *In re J. Menist & Co.,* 290 Fed. 947 (C.C.A. 2, 1923);
People of the State of New York v. *Jersawit,* 263 U. S. 493 (1924);
Dayton v. *Pueblo County,* 241 U. S. 588 (1916);
Horn v. *Boone County,* 44 Fed. (2nd) 920 (C.C.A. 8, 1930);
In re Kallak, 147 Fed. 276 (D. C. N. Dakota, 1906).

In *In re J. Menist & Co., supra,* the Circuit Court of Appeals, Second Circuit, affirmed an order of the District Court in a bankruptcy proceeding directing the payment

of a tax to the United States with interest at the rate of 6% per annum to the date of payment. The Court rejected the Government's claim to interest at the rate of 1% per month on the ground that that rate was a penalty, the payment of which was forbidden by §57j of the Bankruptcy Act. In its opinion the Court said, per HOUGH, J. (290 Fed. at pp. 949-950):

> "The question remains whether a tax demand, duly proved, should continue to draw interest at the legal rate after the filing of petition for adjudication. The general rule is, of course, that interest stops with petition filed (Sexton *v.* Drefus, 219 U. S. 339, 31 Sup. Ct. 256, 55 L. Ed. 244), but a tax debt, due to any of the taxing authorities enumerated in section 64a, is not only a highly preferred debt, but the section contains specific directions that the trustee shall pay 'all taxes legally due and owing.' That means legally due and owing in accordance with the provisions of the Bankruptcy Act, and under that statute section 57j requires penalties due to the United States, or a state, etc., to be allowed to the extent of the pecuniary loss suffered. The loss continues as much after petition filed as before.
>
> We agree with the court below that these directions cannot be fulfilled, except by an order on the trustee to pay the tax, with lawful interest down to the date of actual payment."

This Court reversed the Circuit Court with respect to the rate of interest and held that it should run at the rate of 1% per month, but affirmed so much of the decision of the Circuit Court as held that interest should run on the claim until paid, *United States* v. *Childs, supra.* Upon the appeal to this Court the respondent specifically urged

that interest should not run after the filing of the petition (see 266 U. S. at p. 30). The ruling of this Court settled the law to the effect that interest on tax claims runs until the date of payment.

Meilink, Trustee v. *Unemployment Reserves Commission of California, supra,* reached this Court in 1941, considerably subsequent to the passage of the Chandler Act. This Court cited *United States* v. *Childs, supra,* and affirmed an order of the Circuit Court of Appeals, Ninth Circuit, in a bankruptcy proceeding holding that a State tax should bear interest at the rate of 1% per month to the date of payment and that that rate did not constitute a penalty within the meaning of §57j of he Bankruptcy Act. The question as to the effect of the Chandler Act upon the rule laid down in *United States* v. *Childs, supra,* does not appear to have been argued.

Administrative Code of the City of New York, §N41-17.0, subd. a, and §§R41-14.0, subd. a, and RR41-14.0, subd. a, *infra,* pp. 21-22, providing for interest on unpaid taxes at the rate of 1% per month, are similar to the statutes involved in the *Childs* and *Meilink* cases. In any event, no contention is made by the trustee herein that interest is not allowable at the statutory rate. Applying the *Childs* and *Meilink* decisions to the instant case, it is clear that at least prior to the passage of the Chandler Act, interest on the petitioner's tax claim here involved would run to the date of payment at the rate of 1% per month.

(2)

The contention that the rule as to the running of interest on tax claims was altered by the Chandler Act requires a detailed examination of the changes effected

by that statute with respect to tax claims. We have set forth verbatim in the appendix hereto, *infra*, pp. 24-33, the relevant provisions of the Bankruptcy Act before and after the 1938 amendments and shall now analyze them.

(a)

Section 57j of the Bankruptcy Act (11 U.S.C.A. §93, subd. j) was reenacted by the Chandler Act with only a minor change, the substitution of the phrase "any State or subdivision thereof" for the phrase "a State, a county, a district, or municipality".

As reenacted by the Chandler Act §57j reads as follows:

> "Debts owing to the United States or any State or subdivision thereof as a penalty or forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained by the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interest as may have accrued thereon according to law."

We submit that the reenactment of this section, practically unchanged, by the Chandler Act is of the greatest significance in considering the problem posed by the instant case. It was indeed the principal ground upon which the Court in *Davie v. Green*, 133 Fed. (2nd) 451 (C.C.A. 1, 1943), reached a conclusion contrary to that of the Circuit Court herein, and it was also relied on by Judge Augustus N. Hand in his opinion in *Carter v. United States*, 168 Fed. (2nd) 272 (C.C.A. 2, 1948), which favors our position herein.

In *Davis v. Green, supra*, the Court said per Woodbury, J. [133 Fed. (2nd) at p. 453]:

> "In 1938 when Congress passed the Chandler Act it made many fundamental and far-reaching changes in the law of bankruptcy, but it made only a minor verbal change in §57, sub. j of the Bankruptcy Act of 1898.[1] It left untouched the last words of that section which provide for the payment of debts due the United States or any State or subdivision thereof with 'such interest as may have accrued thereon according to law' which words the courts had repeatedly construed, rightly or wrongly, to mean interest to the date of payment. It is fair to assume that Congress in thoroughly revising the law of bankruptcy became aware of the construction which the courts had placed upon the words which it had previously used, and that if it had wished to change that construction so as to place claims for taxes on the same footing with other claims with respect to interest it would have said so in clear and unmistakable terms. If the old interpretation, to which we feel obliged to adhere, works injustice or hardship upon the general creditors of a bankrupt, relief for them must be sought in Congress."

To this comment we add the fact that on June 8, 1948, the House of Representatives passed a bill introduced by Congressman Reed (H.R. 5693, 80th Congress, 2d Session) to amend the Bankruptcy Act in several respects. Section 11 of the bill provided for the amendment of §57j of the Bankruptcy Act to read as follows:

> "Sec. 57j. (*1*) Debts owing to the United States or *to* any State or any subdivision thereof as a penalty or forfeiture shall not be allowed, except

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"1. It only substituted the phrase 'any State or subdivision thereof' for the phrase 'a State, a county, a district, or a municipality.' (Footnote is part of the opinion.)

for the amount of the pecuniary loss sustained by the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interest as may have accrued [thereon according to law] *on the amount of such loss up to the date of bankruptcy.*

(2) Except where the estate of the bankrupt is solvent, interest accruing after the date of bankruptcy on taxes legally due and owing to the United States or to any State or any subdivision thereof shall not be allowed."[1]

The bill was referred to the Senate Committee on the Judiciary on June 9, 1948 but no action was taken on it prior to the adjournment of Congress or at the recent special session.

The fact that this bill was introduced strongly indicates that the Chandler Act was not intended to change the rule that interest on tax claims runs to the date of payment and the report of the House Committee on the Judiciary with respect to the bill expressly so states.[2]

The Circuit Court, in its opinion herein (R. 37), stated in substance that §57j was not determinative of the question involved because "it seems clearly to be operable only *after* the question as to what, if any, interest is legal has been decided" (Italics the Court's). With due deference, we submit that this comment fails to give full meaning to the wording of the section. Section 57j was and is a clear mandate to pay interest on taxes "according to law", and the settled law prior to the Chandler Act was that such interest ran to the date of payment. If Congress meant to

1. Italicized words are new and bracketed words are to be eliminated.

2. House of Representatives, 80th Congress, 2d Session, Report No. 2083, dated May 28, 1948. The report contains a "General

change that law, the obvious way to do it was to amend §57j accordingly. The Chandler Act, however, made no material change in §57j and by reenacting it evidenced an intent to leave the rule as to interest on taxes unchanged.

Statement" as to the passage of the Chandler Act of June 22, 1938 and refers to the desirability of making certain changes therein. With respect to the proposed changes in §57j the report states:

"'11. Section 11 (a) of the bill is intended both to clarify and modify section 57j of the act. The change in 57j (c) is to make clear that the limitation on interest up to the date of bankruptcy relates only to interest on the 'pecuniary loss,' and further that such interest stops at the date of bankruptcy. The addition of clause (2) in the bill is intended to overrule an obsolete rule as to interest on delinquent tax debts. Interest on general unsecured debts, on unsecured Government debts other than taxes, and on debts entitled to priority under section 64-a, is suspended at the date of bankruptcy so that, except in the rare case of a solvent estate, interest is allowable only to such date. (Sec. 63a; *Adams v. Napa Cantina Wineries* (C.C.A., 9th Cir.), 36 Am. B. R. (N.S.) 8 [94 Fed. (2nd) 694 (1938)]; *In re Gandelfi & Co., Inc.* (S.D. N.Y.), 51 Am. B. R. (N.S.) 521 (governmental debts and other debts entitled to priority); 3 *Collier on Bankruptcy*, 14th Ed., 1835 *et seq.*; 2 *Remington on Bankruptcy*, 4th Ed., secs. 771, 795.) However, interest on delinquent tax debts is allowable to the date of payment (*In re Kallak* (D.C.N.D., 1906); 17 Am. B.R. 414; *In re Ashland Emery and Corundum Co.* (D.C. Mass., 1916), 36 Am. B.R. 194 [229 Fed. 829]; *In re Clark Realty Co.* (C.C.A., 7th Cir., 1918), 42 Am. B.R. 403 [253 Fed. 938]; *sub silentio: United States v. Childs*, 266 U. S. 304, 307 (1924), 5 Am. B.R. (N.S.) 5). *Although, under the Chandler Act, a tax debt is required to be proved (sec. 57n) and its order of priority ranks below all administration costs and expenses, wages and costs and expenses of creditors successfully opposing a settlement or discharge, or procuring a conviction for an offense (sec. 64a (1), (2), (3)), thereby rendering obsolete the reasoning in the Kallak case, nevertheless its rule has not been changed, and therefore requires this statutory modification.* For further discussion see *In re D. O. Summers* (Ref. N.D. Ohio, 1939), 46 Am. B.R. (N.S.) 123; *In re Dorsey* (Ref. W.D. Wash., 1940), 46 Am. B.R. (N.S.) 146; *Davis v. Green* (C.C.A. 1st Cir., 1943), 52 Am. B.R. (N.S.) 603. And on overruling the *Kallak* case see *In re Union Fabrics, Inc.* (S.D. N. Y., 1947), 73 F. Supp. 685, appeal pending." (Italics supplied.)

(b)

The principal change effected by the Chandler Act with respect to tax claims was the amendment of §57n (11 U.S.C.A. §93, subd. n) so as to provide that tax claims be filed within six months after the first date set for the first meeting of creditors, with provision for the Court granting a reasonable extension of time. It is clear that this change was designed to facilitate the administration of bankrupt estates by obviating the necessity of the trustee obtaining bar orders against taxing authorities.

Prior to the Chandler Act, there was no requirement in the Bankruptcy Act that tax claims be filed. Section 57n, which provided for the filing of claims generally, was silent as to tax claims and was therefore held to be inapplicable to them. The result was that the practice had grown up of the trustee asking the Court to issue an order requiring tax claims to be filed within a certain date or be barred. This practice was the only safe and practicable means of administering a bankrupt estate and its validity was upheld by the Courts on numerous occasions. *New York* v. *Irving Trust Co.*, 288 U. S. 329 (1933). Failure to obtain a bar order had the effect of leaving the trustee personally liable for unpaid taxes. *Cf. United States* v. *Kaplan*, 74 Fed. (2nd) 664 (C.C.A. 2, 1935). But even when a bar order was obtained, the Court was empowered to revoke it upon a showing of circumstances justifying such action: *New York* v. *Irving Trust Co.*, *supra*; *United States* v. *Elliott*, 57 Fed. (2nd) 843 (C.C.A. 6, 1932).

This led to uncertainty in the administration of bankruptcy estates which the changes made in §57n by the Chandler Act were designed to overcome. The House

Report[1] and Senate Report[2] on the Chandler Act both make this abundantly clear.

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1. The House of Representatives, 75th Congress, 1st Session, Report No. 1409, dated July 29, 1937, to accompany H.R. 8046, states as follows (p. 3):

> "The bill seeks to accomplish the following general purposes [ten purposes are mentioned of which number 2 is here pertinent]: * * *
>
> "(2) **To increase efficiency in administration.**"

And in discussing this purpose, under the caption **"Amendments to increase efficiency in administration"** (p. 8), the Report states (p. 13):

> "(3) *Claims-Filing*—Section 57: Subdivision n relating to the filing of claims has been entirely recast, and several significant changes have been made.
>
> All proofs of claim, except as otherwise provided in chapters X, XI, XII and XIII, including claims for taxes and debts owing to a government, must be filed and proved. *The provision in respect to government claims is added in order to overcome the decisions which hold that the bar time for the filing of claims is not binding upon a sovereign.* Thus the administration of the estate is speeded up, and the distribution becomes more certain and definite." (Italics supplied.)

2. The Senate, 75th Congress, 3rd Session, Report No. 1916, dated April 20, 1938, to accompany H.R. 8046 states as follows (p. 2):

> "The provisions dealing with claims of Federal and State Governments, particularly with respect to the proving and filing of such claims and the dischargeability of tax claims require modernization."

And speaking of §57n (p. 5):

> "5. *Including government claims within bar time—Extension of time*—**(Sec. 57, subdivision n, p. 76, lines 7 and 10-13).**—The House Bill includes within the bar time for the proving of claims, all claims of the United States and of any State or subdivision thereof. The committee has both strengthened and extended this proposed amendment by providing, first, that such claims must actually be filed within the bar time, and, second, by permitting additional time for the filing of such claims upon application for cause shown. The committee agrees with the proposal that governmental claims should be subjected to the same requirements as other claims but is of the opinion that the limitation should be tempered by the provision for extension, for the reason that it is sometimes difficult for the Government to prepare and present its claims within a fixed time. The limitation will speed up the closing of estates, and the extension will provide a reasonable flexibility."

(c)

In its opinion herein (R. 34-35), the Circuit Court placed an entirely unwarranted emphasis upon the elimination of old §64a by the Chandler Act. The only provision of old §64a which was eliminated was that which required the Court to order the trustee to pay taxes owing by the bankrupt. Even without such a provision the Court was required to direct payment of taxes and the trustee had the obligation to search them out and pay them. *Lewis, Trustee* v. *United States*, 92 U. S. 618 (1875). However, even if that provision had been necessary in order to effect proof and payment of tax claims, the Chandler Act amendment of §57n so as to require the proving and filing of tax claims rendered that portion of old §64a obsolete and unnecessary. Hence the elimination of that provision of old §64a by the Chandler Act is without significance on the issue here.*

* The House Report on Public Bills, 75th Congress, 1st Session, Report No. 1409, dated July 29, 1937, to accompany H.R. 8046 discussed the changes in §§64a and 64b as item (4) under "**Amendments to increase efficiency in administration**" (p. 8) immediately after the discussion of the changes in §57n, which is item (3) (see footnote 1, p. 14, *supra*). Concerning the changes in §64, the Report states (p. 15):

> "(4) *Priorities*—Section 64: Subdivisions a and b have been merged and recast. Subdivision (a) in the present act, which relates to the payment of taxes, has been eliminated, and the subject of taxes transferred to the fourth order of priority in our merged subdivision, which now of course becomes subdivision (a). The limitation in amount of real estate taxes, and the conferring upon the court of jurisdiction to determine the amount or legality of all taxes, are retained. The present subdivision b, which is our new subdivision (a), has been considerably modified. Clauses (1), (2) and (3), which previously classified the costs and expenses of the proceedings in the order prescribed, have been combined and all such costs and expenses given a single order of priority."

The portions of old §64a limiting claims for tax assessments against real property to the value of the bankrupt's interest therein, were broadened to apply to assessments against all property and were incorporated in new §64a. The provisions of old §64b were also incorporated into new §64a by the Chandler Act, without any material change with respect to the priority status of tax claims.

(d)

The Circuit Court also seems to have labored under the impression that the Chandler Act amendments to §§57n and 64a brought tax claims within the provisions of §63a of the Bankruptcy Act (11 U.S.C.A. §103, subd. a), which relates to provable claims and provides that interest on such claims be allowed to the date of the filing of the petition in bankruptcy. Judge CLARK's opinion expressly so states (R. 35). We submit that in this respect the Court was clearly in error. Both before and after the Chandler Act tax claims are nowhere mentioned in §63a and are therefore necessarily excluded therefrom. *Guarantee Co.* v. *Title Guaranty Co.*, 224 U. S. 152, 155 (1912); *New York* v. *Irving Trust Co.*, 288 U. S. 329, 331 (1933); *United States* v. *Herron*, 87 U. S. 251 (1873); *In re Marine Stevedoring Corp.*, 169 Fed. (2d) 554 (C.C.A. 3, 1948); *In re Matisoff*, 36 Fed. Supp. 896 (U.S.D.C. Ga., 1941); *In re Dorb the Chemist Pharmacies*, 29 Fed. Supp. 832 (D.C. S.D. N.Y., 1939).

(e)

The Circuit Court opinion treated as without significance the fact that the Chandler Act made no changes in §17 (11 U.S.C.A. §35), which provides that tax claims are not released by a discharge in bankruptcy. While

not of paramount significance, we think this consideration of some weight. As pointed out in Judge CLARK's opinion (R. 37-38), the question of the discharge of tax claims was carefully considered. The House bill made them dischargeable but the Senate bill reverted to the old law.[1] We think it anomalous to hold that interest on tax claims need not be paid by the trustee but that they are not dischargeable by the bankruptcy. Yet that must be the effect of the ruling of the Circuit Court herein.

(f)

The Bankruptcy Act of 1898 provided in '§64a' that taxes be paid "in advance of the payment of dividends to creditors", and in §64b that debts enumerated therein to have priority be "paid in full". The Bankruptcy Act of 1898 did not list taxes in §64b among the priority claims. In 1926 (44 Stat. 666) taxes were for the first time listed in §64b among the priority claims to be "paid in full".

In the opinion of the Circuit Court in the instant case, Judge CLARK stated that the phrase "paid in full" in old §64b and present §64a, had the effect of limiting the priority of tax claims to payment of principal alone, citing *Hammer* v. *Tuffly*, 145 Fed. (2d) 447 (C.C.A. 2, 1944).

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1. The following remarks were made by Mr. Chandler as to the change in the Senate bill (Congressional Record, Vol. 83, p. 9106, June 13, 1938):

> "Dischargeability of tax claims (sec. 17): The House bill makes Federal taxes dischargeable, while the Senate amendment retains existing law in the clarifying change. The Senate felt that if Federal taxes were made dischargeable, it would open the door to evasion. The Treasury Department recommended against the House amendment."

In that case, a surplus remained after payment to creditors of the bankrupt who had filed their claims on time. The Court held that such creditors were entitled to interest on their claims to the date of payment before distribution of the surplus to a barred creditor who had not filed on time. In the course of his opinion, Judge LEARNED HAND referred to the changes in old §64b effected by the 1926 amendment to the Bankruptcy Act and suggested that they had limited the priority of tax claims to the payment of principal, relying upon certain cases in State courts holding that "payment in full" meant payment of principal only.

Prior to the 1926 amendment the law was well established that interest on tax claims in bankruptcy ran to the date of payment. See cases, *supra*, p. 6. Certainly, the inclusion of taxes among claims to be "paid in full" by the 1926 amendment could not have had the effect of delimiting interest payments on tax claims. This is particularly true in view of the fact that the 1926 amendment made no change in §57j and that section was subsequently reenacted without substantial change by the Chandler Act.

Moreover, the dictum in *Hammer* v. *Tuffy*, *supra*, seems to us to be clearly erroneous in intimating that State law could determine the manner of payment of claims in bankruptcy. Bankruptcy is a federal matter and the payment of claims therein is determined solely by Federal law. *Vanston Committee* v. *Green*, 329 U. S. 156, 163 (1946).

(3)

The views which we advocate herein are supported by most of the cases which have passed on the exact question.

Davie v. *Green*, 133 Fed. (2nd) 451 (C.C.A. 1, 1943), held that interest on a tax claim of the State of New

Hampshire in a bankruptcy proceeding should bear interest at the rate of 1% per month until the date of payment.

Carter v. *United States*, 168 Fed. (2nd) 272 (C.C.A. 2, 1948), the appeal in which is to be argued together with the instant appeal, involved tax claims of the United States and the State of New York in a bankruptcy proceeding. The District Court held that interest should run only until the date of the filing of the petition in bankruptcy. *In re Union Fabrics*, 73 Fed. Supp. 685 (D.C.S.D. N.Y., 1947). While the decision of the District Court was affirmed, the opinion of Judge AUGUSTUS N. HAND expressly states that he and Judge CHASE, constituting a majority of the Circuit Court sitting on the case, agreed with the decision in *Davie* v. *Green, supra*, but acquiesced in the decision of the District Court since it accorded with the views of the majority of the Circuit Court judges as expressed in their opinion herein. Judge CLARK, who wrote the opinion of the Circuit Court herein, sat in the *Carter* case and concurred in the result.

In re Flayton, 42 Fed. Supp. 1002 (D.C.E.D. N.Y., 1942), *In re L. Gandolfi & Co.*, 42 Fed. Supp. 706 (D.C.S.D. N. Y., 1940), *In re Summers*, 45 A.B.R. (N.S.) 123 (Ref. N.D. Ohio, 1939), and *In re Dorsey*, 46 A.B.R. (N.S.) 146 (Ref. W.D. Wash., 1940), all held that interest on tax claims in a bankruptcy proceeding runs until the date of payment.

Conclusion

The Chandler Act reenacted §57j requiring tax claims in a bankruptcy proceeding to be paid with interest, required that tax claims be filed by amending §57n, and left substantially unchanged the order of priority for tax

claim payments in the new §64a. The elimination of old §64a was an incident of the amendment to §57n requiring tax claims to be filed.

These changes do not point to any Congressional intent to change the pre-existing rule that interest on tax claims runs to the date of payment. On the contrary, by the reenactment of §57j they indicate a definite intent to leave unchanged the law as established by *United States* v. *Childs*, *supra*; *Meilink, Trustee* v. *Unemployment Reserves Commission of California*, *supra*; and other decisions (see cases, *supra*, p. 6) that interest on tax claims runs to the date of payment.

The order of the Circuit Court should be reversed, with costs, in so far as it limited the payment of interest to the date of the filing of the petition in bankruptcy, and interest on the petitioner's claim at the rate of 1% per month until the date of payment should be directed to paid.

New York, N. Y., December 3, 1948.

Respectfully submitted,

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APPENDIX

Statutes Involved

1. New York State.

In 1940 and 1941, the Legislature of the State of New York passed Enabling Acts (L. 1940, ch. 245; L. 1941, ch. 200; L. 1941, ch. 199), which authorized the City of New York to impose the sales and business tax for the periods here involved.

We have not reprinted the Enabling Acts since the case does not call for an interpretation of their language.

2. The New York City Local Laws.

The New York City sales taxes here involved were imposed pursuant to the Administrative Code of the City of New York, Chapter 41, Title N, and the business taxes were imposed pursuant to the provisions of the Administrative Code of the City of New York, Chapter 41, Titles R and RR. Each of such Titles of the Administrative Code has a provision imposing penalties and interest in case of failure to file a return or to pay taxes due as required. The provision in Title N of Chapter 41 (sales tax) reads as follows (Adm. Code, §N41-17.0, subd. a, Williams Ed., p. 2121):

> "*Penalties and interest.* a. Any person failing to file a return or to pay or pay over any tax to the treasurer within the time required by this title shall be subject to a penalty of five percentum of the amount of tax due; plus interest at the rate of one percentum of such tax for each month of delay excepting the first month after such return was required to be filed or such tax became due; but the comptroller or as provided in section N41-13.0, the

treasurer if satisfied that the delay was excusable, may remit all or any part of such penalty, but not interest at the rate of six per cent per year. Such penalties and interest shall be paid and disposed of in the same manner as other revenues from this title. Unpaid penalties and interest may be enforced in the same manner as the tax imposed by this title."

The corresponding provision of Title R and Title RR of the Administrative Code (business tax) is practically identical. (See Adm. Code, §R41-15.0, subd. a and §RR41-14.0, subd. a, Williams Ed., pp. 2165, 2176.)

3. The National Bankruptcy Acts.

The provisions of the National Bankruptcy Act relied on and referred to in the opinion of the Court below, §§17, 57j, 57n, 63a, 64a and b (11 U.S.C.A. §§35, 93j, 93n, 103a, 104a and b, respectively), as they read both before and after the Chandler Act of 1938 are set forth, *post*, pp. 24-33.

Pertinent Provisions of the National Bankruptcy Act

Before the Chandler Act

Section 17 (11 U.S.C.A. §35)

"**Debts not affected by a discharge.** A discharge in bankruptcy shall release a bankrupt from all of his provable debts, except such as (first) are due as a tax levied by the United States, the State, county, district, or municipality in which he resides; * * *."

Section 57 (11 U.S.C.A. §93)

Proof and Allowance of Claims.

* * *

(j) Debts owing to the United States, a State, a county, a district, or a municipality as a penalty or forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained by the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interest as may have accrued thereon according to law.

* * *

(n) Claims shall not be proved against a bankrupt estate subsequent to one year after the adjudication; or if they are liquidated by litigation and the final judgment therein is rendered within thirty days before or after the expiration of such time, then within sixty days after the rendition of such judgment: Provided, That the right of infants and insane persons without guardians, without notice of the proceedings, may continue six months longer.

(*Continued on page 26*)

Pertinent Provisions of the National Bankruptcy Act

As Amended by the Chandler Act

Section 17 (11 U.S.C.A. §35)

"**Debts not affected by a discharge.** A discharge in bankruptcy shall release a bankrupt from all of his provable debts, whether allowable in full or in part, except such as (1) are due as a tax levied by the United States, or any State, county, district, or municipality; * * *."

Section 57 (11 U.S.C.A. §93)

Proof and Allowance of Claims.

* * * *

(j) Debts owing to the United States or any State or subdivision thereof as a penalty or forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained by the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interest as may have accrued thereon according to law.

* * * *

(n) Except as otherwise provided in this title, all claims provable under this title, including all claims of the United States and of any State or subdivision thereof, shall be proved and filed in the manner provided in this section. Claims which are not filed within six months after the first date set for the first meeting of creditors shall not be allowed: *Provided, however,* That the court may, upon application before the expiration of such period and for cause shown, grant a reasonable fixed extension of time

(*Continued on page 27*)

Section 63a [11 U.S.C.A. §103(a)]

Debts provable against

(a) Debts of the bankrupt may be proved and allowed against his estate which are (1) a fixed liability, as evidenced by a judgment or an instrument in writing, absolutely owing at the time of the filing of the petition against him, whether then payable or not, with any interest thereon which would have been recoverable at that date or with a rebate of interest upon such as were not then payable and

(*Continued on page* 28)

for the filing of claims by the United States or any State or subdivision thereof: *Provided further*, That, except in proceedings under chapters 10, 11, 12, and 13 of this title, the right of infants and insane persons without guardians, without notice of the bankruptcy proceedings, may continue six months longer: *And provided further*, That a claim arising in favor of a person by reason of the recovery by the trustee from such person of money or property, or the avoidance by the trustee of a lien held by such person, may be filed within thirty days from the date of such recovery or avoidance, but if the recovery is by way of a proceeding in which a final judgment has been entered against such person, the claim shall not be allowed if the money is not paid or the property is not delivered to the trustee within thirty days from the date of the rendering of such final judgment, or within such further time as the court may allow. When in any case all claims which have been duly allowed have been paid in full, claims not filed within the time hereinabove prescribed may nevertheless be filed within such time as the court may fix or for cause shown extend and, if duly proved, shall be allowed against any surplus remaining in such case.

Section 63a [11 U.S.C.A. §103(a)].

Debts which may be proved

a. Debts of the bankrupt may be proved and allowed against his estate which are founded upon (1) a fixed liability, as evidenced by a judgment or an instrument in writing, absolutely owing at the time of the filing of the petition by or against him, whether then payable or not,

(*Continued on page 29*)

did not bear interest; (2) due as costs taxable against an involuntary bankrupt who was at the time of the filing of the petition against him plaintiff in a cause of action which would pass to the trustee and which the trustee declined to prosecute after notice; (3) founded upon a claim for taxable costs incurred in good faith by a creditor before the filing of a petition in an action to recover a provable debt; (4) founded upon an open account, or upon a contract express or implied; (5) founded upon provable debts reduced to judgments after the filing of the petition and before the consideration of the bankrupt's application for a discharge, less costs incurred and interest accrued after the filing of the petition and up to the time of the entry of such judgment; (6) founded upon an award of an industrial accident commission, or other commission, body or officer, of any State or Territory having power or jurisdiction to make awards as workmen's compensation in case of injury or death for injury prior to adjudication; (6½) the amount of any damages, as evidenced by a judgment of a court of competent jurisdiction, in any action for negligence instituted prior to adjudication of defendant in such action in bankruptcy and pending at the time of the filing of petition in bankruptcy, whether voluntary or involuntary; *Provided*, That the provisions of this clause (6½) shall apply to estates that were pending on June 7, 1934, and are in process of settlement; and (7) claims for damages respecting executory contracts including future rents whether the bankrupt be an individual or a corporation, but the claim of a landlord for injury resulting from the rejection by the trustee of an unexpired lease of real estate or for damages or indemnity under a

(*Continued on page 30*)

with any interest thereon which would have been recoverable at that date or with a rebate of interest upon such as were not then payable and did not bear interest; (2) costs taxable against a bankrupt who was at the time of the filing of the petition by or against him plaintiff in a cause of action which would pass to the trustee and which the trustee declines to prosecute after notice; (3) a claim for taxable costs incurred in good faith by a creditor before the filing of the petition in an action to recover a probable* debt; (4) an open account, or a contract express or implied; (5) provable debts reduced to judgments after the filing of the petition and before the consideration of the bankrupt's application for a discharge, less costs incurred and interest accrued after the filing of the petition and up to the time of the entry of such judgments; (6) an award of an industrial-accident commission, body, or officer of any State having jurisdiction to make awards of workmen's compensation in case of injury or death from injury, if such injury occurred prior to adjudication; (7) the right to recover damages in any action for negligence instituted prior to and pending at the time of the filing of the petition in bankruptcy; (8) contingent debts and contingent contractual liabilities; or (9) claims for anticipatory breach of contracts, executory in whole or in part, including unexpired leases of real or personal property: *Provided, however,* That the claim of a landlord for damages for injury resulting from the rejection of an unexpired lease of real estate or for damages or indemnity under a covenant contained in such lease shall in no event be allowed in an amount exceeding the rent reserved by the lease, without acceleration, for the year

* So in original. Should read "provable".

(*Continued on page* 31)

covenant contained in such lease shall in no event be allowed in an amount exceeding the rent reserved by the lease, without acceleration, for the year next succeeding the date of the surrender of the premises, plus an amount equal to the unpaid rent accrued up to said date: *Provided*, That the court shall scrutinize the circumstances of an assignment of future rent claims and the amount of the consideration paid for such assignment in determining the amount of damages allowed assignee hereunder: *Provided further*, That the provisions of this clause (7) shall apply to estates pending on June 7, 1934, in which the time for filing such claims has not expired.

Section 64 (11 U.S.C.A. §104)

Debts which have priority.

(a) The court shall order the trustee to pay all taxes legally due and owing by the bankrupt to the United States, State, county, district, or municipality, in the order of priority as set forth in paragraph (b) hereof: *Provided*, That no order shall be made for the payment of a tax assessed against real estate of a bankrupt in excess of the value of the interest of the bankrupt estate therein as determined by the court. Upon filing the receipts of the proper public officers for such payments the trustee shall be credited with the amounts thereof, and in case any question arises as to the amount or legality of any such tax the same shall be heard and determined by the court.

(b) The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment shall be

(Continued on page 32)

next succeeding the date of the surrender of the premises to the landlord or the date of reentry of the landlord, whichever first occurs, whether before or after bankruptcy, plus an amount equal to the unpaid rent accrued, without acceleration, up to such date: *And provided further*, That in the case of an assignment of any such claim for damages, the court shall, in determining the amount thereof, examine the circumstances of the assignment and the consideration paid or to be paid therefor, and may allow the claim of the assignee in such amount, subject to the provisions of the foregoing proviso of this clause (9), as will be fair and equitable.

Section 64 (11 U.S.C.A. §104)

Debts which have priority

(a) The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be (1) the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition; the fees for the referees' salary fund and for the referees' expense fund; the filing fees paid by creditors in involuntary cases; where property of the bankrupt, transferred or concealed by him either before or after the filing of the petition, shall have been recovered for the benefit of the estate of the bankrupt by the efforts and at the cost and expense of one or more creditors, the reasonable costs and expenses of such recovery; the costs and expenses of administration, including the trustee's expenses in opposing the bankrupt's discharge, the fees and mileage payable to witnesses as now or hereafter provided by the laws of the United States, and one reasonable attorney's fee, for the professional services actually rendered, irrespective of the number of

(*Continued on page* 33)

(1) the actual and necessary cost of preserving the estate subsequent to filing the petition; (2) the filing fees paid by creditors in involuntary cases, and, where property of the bankrupt, transferred or concealed by him either before or after the filing of the petition, shall have been recovered for the benefit of the estate of the bankrupt by the efforts and at the expense of one or more creditors, the reasonable expense of such recovery; (3) the cost of administration, including the fees and mileage payable to witnesses as now or hereafter provided by the laws of the United States, and one reasonable attorney's fee, for the professional services actually rendered, irrespective of the number of attorneys employed, to the petitioning creditors in involuntary cases while performing the duties herein prescribed, and to the bankrupt in voluntary and involuntary cases, as the court may allow; (4) where the confirmation of composition terms has been refused or set aside upon the objection and through the efforts and at the expense of one or more creditors, in the discretion of the court, the reasonable expenses of such creditors in opposing such composition; (5) wages due to workmen, clerks, traveling or city salesmen, or servants, which have been earned within three months before the date of the commencement of the proceeding, not to exceed $600 to each claimant; (6) taxes payable under paragraph (a) hereof and (7) debts owing to any person who by the laws of the States or the United States is entitled to priority: *Provided*, That the term "person" as used in this section shall include corporations, the United States and the several States and Territories of the United States.

attorneys employed to the petitioning creditors in involuntary cases and to the bankrupt in voluntary and involuntary cases, as the court may allow; (2) wages, not to exceed $600 to each claimant, which have been earned within three months before the date of the commencement of the proceeding, due to workmen, servants, clerks, or traveling or city salesmen on salary or commission basis, whole or part time, whether or not selling exclusively for the bankrupt; (3) where the confirmation of an arrangement or wage-earner plan or the bankrupt's discharge has been refused, revoked, or set aside upon the objection and through the efforts and at the cost and expense of one or more creditors, or, where through the efforts and at the cost and expense of one or more creditors, evidence shall have been adduced resulting in the conviction of any person of an offense under this title, the reasonable costs and expenses of such creditors in obtaining such refusal, revocation, or setting aside, or in adducing such evidence; (4) taxes legally due and owing by the bankrupt to the United States or any State or any subdivision thereof: *Provided*, That no order shall be made for the payment of a tax assessed against any property of the bankrupt in excess of the value of the interest of the bankrupt estate therein as determined by the court: *And provided further*, That, in case any question arises as to the amount or legality of any taxes, such question shall be heard and determined by the court; and (5) debts owing to any person, including the United States, who by the laws of the United States is entitled to priority, and rent owing to a landlord who is entitled to priority by applicable State law: *Provided, however*, That such priority for rent to a landlord shall be restricted to the rent which is legally due and owing for the actual use and occupancy of the premises affected, and which accrued within three months before the date of bankruptcy.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1948.

No. 168.

THE CITY OF NEW YORK,

Petitioner,

vs.

LEWIS H. SAPER, as Trustee in Bankruptcy of SPOTLIGHT PRODUCTIONS, INC.,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR RESPONDENT.

DAVID HAAR,
Attorney for Respondent.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1948.

No. 168.

THE CITY OF NEW YORK,

Petitioner,

vs.

LEWIS H. SAPER, as Trustee in Bankruptcy of SPOTLIGHT PRODUCTIONS, INC.,

Respondent.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR RESPONDENT.

The statement of facts presented by the petitioner is substantially correct. And, as indicated in its brief, this appeal concerns itself with but one question, namely, was the order of the Circuit Court of Appeals for the Second Circuit correct in reversing the order of the District Court, by eliminating the petitioner's claim of interest on its tax claim up to the date of payment? To state the problem more broadly, is a tax claim entitled to payment of interest beyond the date when the petition in bankruptcy was filed?

The Argument.

POINT I.

Petitioner's contention that there is an "established rule" that interest runs on taxes to the date of payment, is erroneous.

Throughout its argument the petitioner seems to advance the contention that there is an "established rule" requiring the payment of interest on tax claims up to the date of payment.

We fail to find anywhere in the petitioner's brief, any reference to the "rule". If there is such a "rule" it should be found either in the Bankruptcy Act, or in the General Orders of this Court covering bankruptcy administration or, perhaps, in one of the rules of the District Court for the Southern District of New York. There is no such rule. Quite the contrary. The question of the payment of interest on taxes up to the date of payment has created considerable controversy.

In the same year that the case of *In re Kallak*, 147 Fed. 276 (D. C. N. Dakota, 1906), upon which petitioner relies so much, was decided, there was a case in New Jersey that decided just the opposite. We refer to the case of *In re Fischer & Co.* (148 Fed. 907) (D. C. N. J., 1906). There, too, the question arose as to whether the trustee was required to pay taxes plus interest to the date of payment. The Court said:

> "They (the Trustees) must therefore pay the taxes. It should be noted, however, that section 64 of the Bankruptcy Act does not provide for the

payment of interest on taxes, and the order will therefore be simply that the trustees pay the amount of the taxes without interest."

If there ever was such a rule as the petitioner urges upon this Court, it was challenged by the Referee in the case of *Matter of Dorsey* (1941), 46 A. B. R. (N. S.) 146. The Referee indicated in his opinion that he felt a sense of injustice to permit the payment of interest on taxes up to the date of payment. He said:

> "The position of the claimant is that during the period when there was no money to pay the claim the general creditors must not only pay the expense of getting together sufficient money to pay it in full, but also out of the 10% to 15% allowed to them they must pay interest to the state. This may be the law, but a mere statement of the facts awakens a keen sense of injustice."

Referee Frebolin, in the case of *In re D. O. Summers Co.*, 45 A. B. R. (N. S.) 123, felt himself bound to follow the precedent of the *Kallak* and similar cases. But he added that he had great doubts as to the soundness of the practice of paying interest on taxes up to the date of payment. He followed the precedent, saying, however, that he would do so "until some decision is rendered directly upon this point by the Supreme Court, or a Court whose decision is binding upon me."

What the petitioner calls an "established rule" is more in the nature of a practice, and even that cannot be considered as a precedent upon which to base an argument of a universal rule. Anyone familiar with bankruptcy administration knows that in a great many cases where tax claims are filed by the federal

government, the state government and the municipality, those tax claims consume the bulk of the estate, even without the addition of interest. In other words, since tax claims follow the payment of administration costs, and wage earners who also have priority, there comes a point where the balance left in the trustee's hands is not sufficient to pay even the amount of the tax claims, let alone the payment of any interest. In those cases the question of interest does not arise at all, with the result that rarely has there been any occasion to challenge the demand for interest on the part of the tax collector up to the date of payment. In those few cases where there was enough money to pay administration expenses, priority claims and tax claims, there has been some challenge made to the inclusion of interest. That challenge resulted in the opinions which we have indicated above, some for, and some against, the practice.

But to say that there is a "rule" which makes mandatory the payment of interest on taxes to the date of payment is to start with a wrong premise. There is no such "rule". The divergence of opinion among referees in bankruptcy, and among the higher courts, shows the absence of a "rule". The very fact that this Court has granted the petition for certiorari (to which we consented) emphasizes the diversity of opinion on the subject, and hence the absence of a "rule".

It is because of the absence of such a rule of guidance that this case has been taken to this Court, with the issue clearly presented on the single question in dispute, with the expectation that there will be a decisive opinion on the subject which will serve as a guide in the administration of bankruptcy cases.

In our argument we expect to show that, under the Bankruptcy Act, a tax is a debt—nothing more nor less—and that, as such, it stands on the same footing as debts due to other creditors, with the exception that the Bankruptcy Act requires payment in full of the tax that is due the government.

But the Act does not require payment of more than "in full" of the tax. Payment of the tax itself as a priority is authorized by law. We shall also show that payment of interest is not payment of a tax, and forms no part of it. Hence, payment of the interest beyond the date of petition filed is payment of more than "in full", because interest is not a tax.

POINT II.

The cases which allowed interest to run on taxes up to the date of payment, overlooked the nature of a tax, as distinguished from interest because of non-payment of the tax.

(A) A tax is a debt under the Bankruptcy Act.

Petitioner's counsel urges that the Chandler Act amending Section 64, did not convert a tax into a "debt" standing on a par with the debts due to other creditors.

We suppose that that argument is advanced because of the comment in the opinion of the Circuit Court on the amendment to Section 64 of the Bankruptcy Act in 1938 which it would seem, changed the former status of a tax claim to that of a "debt". But a careful reading of the opinion indicates clearly that the full recognition of a tax claim as a "debt" was also due to other factors, brought about by other changes

in the Bankruptcy Act. The Court stressed the history of the various amendments to the Act, and the revised practice brought about by these amendments, with respect to the method of proving tax claims in a bankruptcy case. The Court said:

> "At any rate, the process of assimilation of tax claims to other debts appears, to us at least, to have been completed by the Chandler amendments of 1938. Indeed we thus described the changes in *United States* v. *Roth*, *supra*, 164 F. 2d at pages 577, 578: 'By the 1938 amendments, however, taxes were classified as "debts" within section 64, sub. a, 11 U. S. C. A. Sec. 104, sub. a, and Section 57, sub. n, 11 U. S. C. A. Sec. 93, sub. n, was broadened to include "all claims of the United States" and require them to "be proved and filed in the manner provided in this section." Subdivision a of section 57, 11 U. S. C. A. Sec. 93, sub. a, provides that a proof of claim shall state among other matters "that the claim is justly owing from the bankrupt to the creditor"; * * * Thus it is apparent that the Act, as it now stands, treats the tax claim as a debt and the United States as a creditor which, like other creditors, must make proof of claim on a form prescribed by the Supreme Court. This, then, took from tax claims their former favored position where no proof or other governmental action was necessary for their enforcement. Thenceforth they must be proved, or otherwise be barred, just like other debts of the bankrupt."

The Court speaks of the "process of assimilation". The nature of a tax as a "debt" had long been foreshadowed in some of the cases. Indeed, in the very

case cited by the petitioner, to-wit, *In re J. Menist & Co.*, 290 F. 947 (C. C. A. (2) 1923), the Court refers to a tax claim as a species of a debt, and then cites *In re Sherwood* (210 F. 754) and *King Boiler Works* v. *Schall* (230 F. 587), as authorities which unquestionably consider taxes as debts owing to the government.

The "process of assimilation" was brought about by the requirement that taxing authorities must file proofs of claim as other creditors do. This requirement was not in existence prior to the amendment of 1938. As stated by the Court below, the proofs of claim to be used by the taxing authorities are exactly the same as the forms prescribed for unsecured creditors. Those proofs of claim must state the same facts as have to be stated by an unsecured creditor, and, under the decision in *U. S.* v. *Roth* (164 F. (2) 575), tax claims are no longer immune against set-offs on the part of the trustee, just the same as unsecured creditors are subject to the right of set-off.

Viewed by and large, the claim of a governmental authority for the payment of a tax due to it from the taxpayer, is nothing more nor less than a debt, because the amount of money set forth in the claim is owing from the taxpayer to the government. The taxpayer is a debtor; the government is a creditor; and that which is owing is unquestionably a debt subject to the same rights and obligations that any other debt of an unsecured creditor is subject to.

The only distinction given to the tax claim is that it is entitled to priority of payment. That distinction is given also to a wage-earner. But the wage-earner gets no interest after the date of the filing of the petition. If his debt gets priority, but no interest, why should a debt due to a governmental authority receive interest merely because it has priority of payment of the debt?

(B) Interest is not a tax.

It needs scarcely any citation of authorities to convince this Court that interest is compensation for the use of money owing to a creditor, or its payment is required because of delay in payment of the debt due to a creditor.

Interest is usually exacted either by express contract, or by implication of law, or by statute. In the case of taxes, payment of interest is required by statute. But even that does not convert interest into a tax. We quote:

> "Interest on a tax is not a tax, but is something in addition to a tax. The additions to the tax, or additional amounts added to the tax, are not the tax which is referred to in the statute which we can find has been overpaid."
>
> *Capital Building & Loan Assn. v. Commissioner*, 23 B. T. A. 848.

In that case the question before the Board of Tax Appeals involved its jurisdiction to order a refund of interest paid on a tax. The Court held it had no jurisdiction to require a refund of overpayment of interest because, as stated, interest is not a tax. It is something in addition to the tax.

This case was cited with approval and followed in *Penrose v. U. S.* (18 F. Supp. 413, at 415) where again the question arose as to whether interest is a tax permitting its deduction in an estate proceeding. The Court ruled that interest is not a tax.

If interest is not a tax, then it is not entitled to priority of payment as a tax claim is. That too is another reason for our contention that where the Bankruptcy Act provides for the priority payment of a tax, that provision does not include the payment of interest after the date of bankruptcy, when all interest stops. *Sexton* v. *Dreyfuss* (219 U. S. 339, at 344); *Vanston Bondholders Protective Committee* v. *Green* (329 U. S. 156) (cited at page 18 in petitioner's brief as "*Vanston Commission* v. *Green* 329 U. S. 156").

POINT III.

Section 57j of the Bankruptcy Act has been misconstrued as applying to interest on taxes.

Counsel for petitioner lays much stress in support of its contention upon the case of *In re J. Menist & Co.* (290 F. 947 (C. C. A. 2, 1923)) in connection with its argument that interest on a tax is payable up to the time of payment. A portion of the opinion is given at page 7 of its brief.

A reading of that portion of the opinion clearly indicates that the Court fell into error in holding that Section 57j of the Bankruptcy Act is applicable to the question of interest on the tax. The opinion refers to Section 57j as the basis for the conclusion.

But Section 57j clearly refers to penalties and forfeitures. It provides for the elimination of such penalties and forfeitures in a bankruptcy case, except that they may be allowed to the extent of the actual pecuniary loss suffered by the penalizing governmental authority.

But a tax, as we have seen, is not a penalty. It is a *debt*. No citizen who pays a tax considers himself penalized by reason of his contribution towards the

expense of running the government. The interest which he pays for delay in payment of the principal debt due to the government surely is not a penalty, no more than it is a penalty when he agrees to pay interest on a loan, or when the courts require the payment of interest for delay in paying a note, or other obligation.

We respectfully suggest that that case loses its force as an authority for the contention of the petitioner, since that case proceeded on the erroneous assumption that interest on a tax is payable under Section 57j of the Bankruptcy Act. Interest is not a penalty, and hence Section 57j cannot apply.

Nor did this Court approve the practice, nor base its decision on that of the lower Court, as the petitioner seems to claim by citing *U. S. v. Childs* (266 U. S. 304). This Court, in that decision, neither approved, nor disapproved the collection of interest on taxes as a priority up to the date of payment. It said nothing about it. All this Court did was to reverse the decision of the lower Court which had fixed the interest at 6% when the government had yielded on the 5% penalty by eliminating it from its claim, but insisted on the 1% interest. All that this Court held was that the Court below was in error in disallowing interest at 1% per month. It did not pass on the question as to whether that 1% per month was payable up to the date of bankruptcy, or up to the date of payment.

It is therefore respectfully submitted that any argument under Section 57j of the Bankruptcy Act is wholly beside the point, because interest is not a penalty, and the question of its payment or non-payment cannot be considered as coming within the purview of that section.

POINT IV.

From the point of view of orderly bankruptcy administration, and of fairness to other creditors, the practice of paying interest on tax claims up to the date of payment should be discontinued.

The Court below gave as another reason for stopping interest on all debts as of the date of bankruptcy, that it is a matter of administrative convenience, and fundamental justice and equity, that interest should stop on the date when the petition was filed (Record, p. 33).

The protest because of this inequity was foreshadowed in *In re Dorsey* (1941), 46 A. B. R. (N. S.) 146. The practice was challenged by Referee Frebolin in *In re D. O. Summers*, 45 A. B. R. (N. S.) 123, and severely condemned by Judge Bright in the case of *In re Union Fabrics* (D. C. S. D. N. Y.), 73 Fed. Supp. 685. This last mentioned case is now before this Court on the petition of New York State against Carter, Trustee (Nos. 200 and 201), and will probably be argued together with this case.

To all those who practice in bankruptcy and who represent creditors in the administration of bankrupt estates, it is repugnant to the sense of fairness that such a practice, as is urged by the petitioner in this case, should be continued. The reason for that feeling of unfairness can be recognized when you consider just what happens to an estate in the process of bankruptcy administration, when the practice of paying interest on taxes up to the date of payment is enforced.

The interest is paid out of the fund in the hands of the Trustee available to all creditors. If the fund is large enough to pay administration expenses, priority claims, and unsecured creditors, then the payment of interest reduces the amount payable to unsecured creditors. It is they who are the losers. But these unsecured creditors have done nothing to bring that loss upon themselves. If interest is to be paid on a tax debt because of delay in payment, that delay is not caused by them. Not in a single instance is delay in payment of taxes caused by the unsecured creditors. Sometimes delay is caused by an empty bank account—there is no money in the estate to start with. If money is brought into the estate, that result is brought about by a diligent trustee, assisted by an equally diligent and able attorney, and very often with money advanced by the creditors for investigation. Sometimes delay is caused by legal controversies arising in the course of administration, which make appeals necessary. This makes it impractical to pay taxes, or interest, because the costs of administration come ahead of taxes. Sometimes (as in this case) the delay is caused by the governmental agency itself in not filing a proper tax in the first place, making objections necessary. These are followed by hearings, petitions to review, appeals to the Court of Appeals, sometimes followed by appeal to this Court.

Who gains by these delays? To whom do these delays mean a loss? The questions answer themselves. If ever there was a "rule" requiring the payment of interest up to the date of payment of the tax, that rule is not only "obsolete", to borrow a characterization from the Report of the Senate Committee (footnote on p. 14 of Petitioner's brief) but it should never

have been a "rule" in the first place. Now that the question has come squarely before this Court for decision, we respectfully urge that the answer should be the common-sense one, the one that squares with the broad principles underlying bankruptcy administration, viz. all debts cease bearing interest—compensation for delay in payment of principal—as of the day that the bankruptcy petition is filed.

Conclusion.

We have not undertaken to discuss all of the various cases cited by the petitioner in its brief. We have discussed a few of them, but an examination of everyone, from the case of *In re Kallak* down, clearly indicates the erroneous assumption which led to the practice of paying interest up to the date of payment, to-wit, that interest is a penalty and comes under Section 57j of the Bankruptcy Act. We hope that we have convinced the Court by this argument that Section 57j does not apply. Indeed, that same error has crept into the argument of the petitioner; for, on page 6 of its brief, at the very outset of its argument, its counsel states that prior to the passage of the Chandler Act in 1938, "the rule was well established that by virtue of the provisions of Section 57j tax claims in bankruptcy bore interest to the date of payment". They then cite cases to support this erroneous premise from which their argument stems.

But we respectfully submit that counsel is wholly in error. Section 57j does not apply at all, because interest is not a penalty, and therefore, the cases they cite are wholly inappropriate to support the argument on the problem now before the Court.

From a careful consideration of all of the factors that enter into a proper discussion of the problem now before the Court, it seems to us that the decision of the Circuit Court of Appeals for the Second Circuit, in reversing the order of the District Court and declaring, with decisiveness, at long last, that taxes, like all other debts, do not bear interest beyond the date of bankruptcy, should be affirmed.

Respectfully submitted,

DAVID HAAR,
Attorney for Respondent.

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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1948

No. 200

STATE OF NEW YORK,

Petitioner,

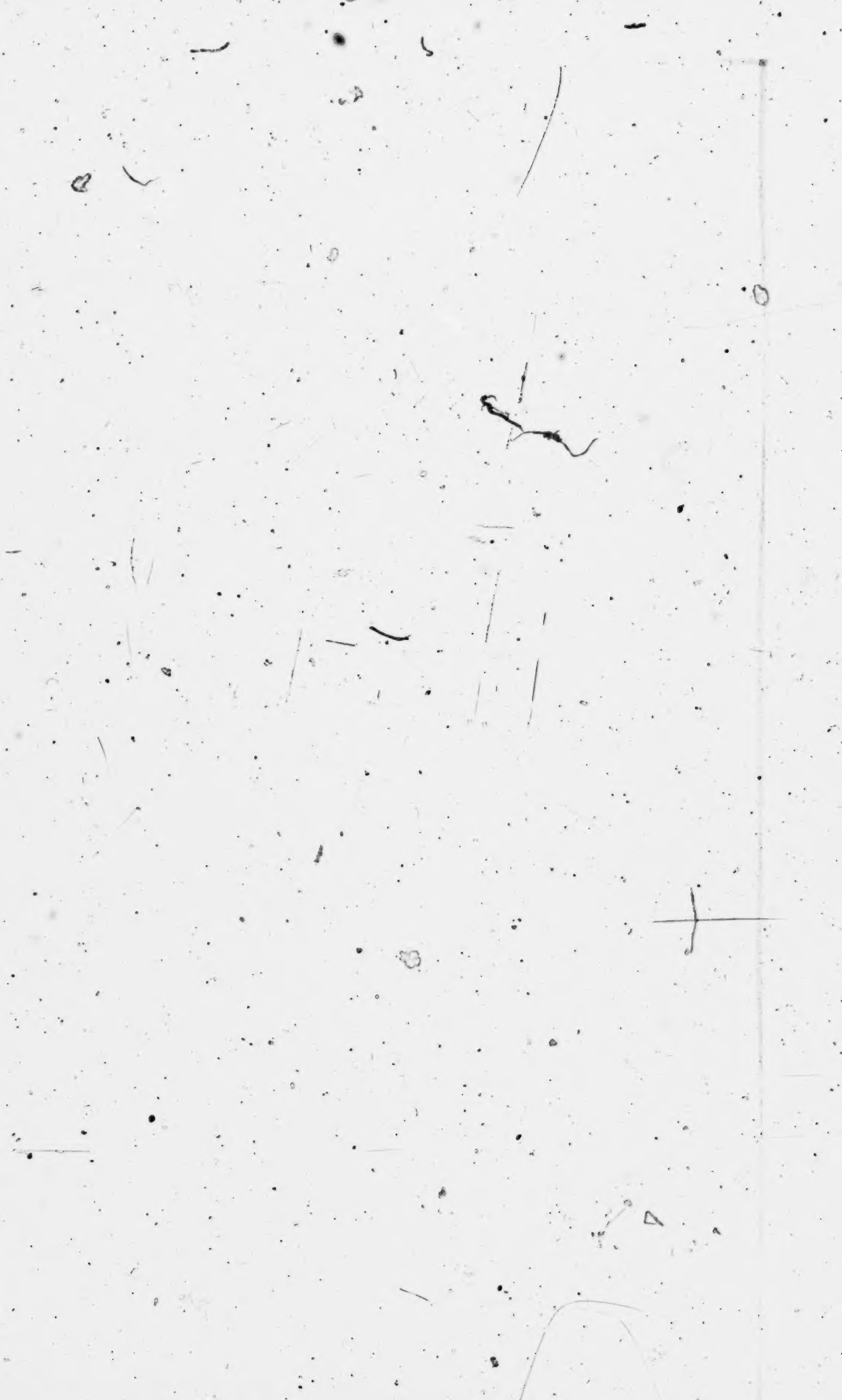
vs.

LEONARD H. CARTER, AS TRUSTEE IN BANKRUPTCY

Respondent.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT AND BRIEF IN SUPPORT THEREOF.

NATHANIEL L. GOLDSTEIN,
Attorney General of the State of New York;
WENDELL P. BROWN,
Solicitor General of the State of New York,
Counsel for Petitioner.



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SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1948

No. 200

IN THE MATTER OF

UNION FABRICS, INC.,

Bankrupt,

STATE OF NEW YORK

Petitioner,

vs.

LEONARD H. CARTER, TRUSTEE IN BANKRUPTCY,

Respondent

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

May it Please the Court:

The Petitioner, State of New York, respectfully shows to this Honorable Court:

Summary Statement of the Matter Involved

An involuntary petition in bankruptcy was filed against Union Fabrics, Inc. on December 20, 1939, and said corporation was thereafter adjudged a bankrupt (R. 4). Leonard

H. Carter was hereupon appointed trustee in bankruptcy and is still acting as such.

Thereafter, and within the time prescribed by statute, the New York State Tax Commission filed a claim in this proceeding for franchise taxes under Article 9-A of the Tax Law of the State of New York, in the amount of $1,403.14, verified May 29, 1940, for the years 1936, 1937 and 1938, and the Industrial Commissioner filed a claim for unemployment insurance taxes covering the period January 1, 1936 to October 28, 1939, in the sum of $257.78, verified June 4, 1940. There is no dispute as to the amount of these taxes (R. 29).

By notices dated July 1 and July 2, 1946, the trustee filed objections to demands for interest on these tax claims beyond the date of the filing of the petition in bankruptcy (R. 5). After hearings, the referee on January 24, 1947, filed his findings of fact and conclusions of law based thereon, overruling the trustee's objections to the allowance of interest to the date of payment (R. 5). Upon a petition by the trustee and an order to show cause based thereon, dated February 6, 1947, the hearings with respect to the objections as to interest were reopened before the referee on February 13, 1947 (R. 5). The trustee thereupon attempted to offer evidence with respect to certain actions and proceedings taken by him against the former president of the bankrupt, which resulted in the receipt of the sum of $30,000 from the former president of the bankrupt in settlement of said claim (R. 5-8; 33-38). The referee sustained objections to this offered proof (R. 38), and granted the allowance of interest on said tax claims to the date of payment (R. 29).

The trustee applied to the United States District Court for the Southern District of New York for a review of the order of the referee. The petition to review was granted and the order of the referee allowing interest to the date of payment of these tax claims and sustaining the objec-

tions to the trustee's offer of the proof, referred to above, was reversed (R. 17-19).

An appeal from the order of the District Court was taken by the State of New York to the Circuit Court of Appeals for the Second Circuit. Although two of the three Circuit Court judges who heard this case did not agree with the decision of the District Court, and were of the opinion that interest on tax claims should be allowed to the date of their payment (R. 41-44), the court affirmed the order of the District Court (R. 45) in view of the fact that, on the same day the opinion of the court in the instant case was handed down, the Circuit Court also handed down a unanimous opinion in *Saper* v. *City of New York*, — F. (2d) —, holding tax claims of the City of New York to be entitled to carry interest only to the date of the filing of the petition in bankruptcy. Since the opinion in the *Saper* case has not been officially reported at the time of the preparation of this petition and is not contained in the transcript of the record, we are attaching a copy thereof to this petition for the convenience of the Court.

Of the five judges who were concerned with these two cases, three were of the opinion that tax claims are entitled to carry interest to the date of the filing of the petition only, while two judges were of the opinion that such claims bear interest to the date of payment. The two judges who were of the opinion that the order of the District Court should be reversed in the instant case felt bound by the opinion of the three judges who sat in *Saper* v. *City of New York*, *supra*.

The majority view, as expressed in the *Saper* case, which was considered binding in the instant case, was that by the Chandler Act amendments of 1938, taxes were classified as "debts" within § 64, subd. a of the Bankruptcy Act (11 U. S. C. A. § 104, subd. a), and that § 57, subd. n of the Bankruptcy Act (11 U. S. C. A. § 93, subd. n) was broadened

to include all tax claims and requires them to be proved and filed in the manner provided in that section, and furthermore, that § 57 provides that a proof of claim shall state, among other things "that the claim is justly owing from the bankrupt to the creditor." From these amendments, the court reasoned, it is apparent that tax claims are to be treated as debts and that the sovereign, like other creditors, must make proof of claim on a form prescribed by the Supreme Court. The court concluded that by reason of these changes tax claims were taken from their former favored position. The court saw no reason to suppose that these changes did not place tax claims in the same situation as other debts with respect to interest also.

The two judges in the instant case, who were of the opinion that the order of the District Court should be reversed, took the view that since tax claims were accorded interest to the date of payment prior to the Chandler Act amendments, clear and specific Congressional intent to change the rule is required, but that no such intent is apparent (R. 44, 45).

Petitioner seeks a review by certiorari in this Honorable Court to determine whether, in a bankruptcy proceeding, interest on claims of the State of New York for franchise and unemployment insurance taxes should be allowed to the date of their payment or to the date of the filing of the petition only.

Questions Presented

The questions which are presented for review are:

1) Is the State of New York entitled to interest on its tax claims against a bankrupt estate to the date of the payment of the claim?

2) Is evidence of extensive litigation between the trustee and the bankrupt's former president, tending to show the reason why the estate was not closed on an earlier date,

sufficient to warrant the denial of interest on such claims to the date of payment?

Reasons Relied Upon For Allowance of the Writ

The following are respectfully submitted by your petitioner and relied upon as reasons for granting of the writ:

a) The act of the Circuit Court of Appeals for the Second Circuit in holding that tax claims carry interest to the date of the filing of the petition in bankruptcy only, and not to the date of the payment of the claim, is directly contrary to the holding of the Circuit Court of Appeals for the First Circuit upon the same question in *Davie* v. *Green*, 133 F. (2d) 451.

b) There is a wide divergence of opinion among the Circuit Judges for the Second Circuit upon this question, since two of the three judges in the instant case were of the opinion that the State is entitled to interest on its tax claims to the date of payment, while the three judges who heard the case of *Saper* v. *City of New York*, decided on the same day, were of the opinion that tax claims carry interest to the date of the filing of the petition only.

c) The decision of the Circuit Court of Appeals for the Second Circuit is of public interest and affects the administration of bankrupt estates throughout the country and presents a fundamental question of law upon which there should be no diversity of opinion in the various Federal courts of the country; the uncertainty created by this conflict adversely affects the expeditious administration and closing of innumerable pending bankruptcy cases, and will continue to do so unless and until this court shall exercise its power of supervision and hear and determine the questions presented.

Petitioner understands that the United States of America also intends to file an application for certiorari in this case as it relates to the judgment of the Circuit Court disallowing interest on its tax claims to the date of payment, and the State of New York supports such petition.

Wherefore, your petitioner respectfully prays that a writ of certiorari be issued out of and under the seal of this Honorable Court, directed to the United States Circuit Court of Appeals for the Second Circuit, commanding that court to certify and send to this Court for its review and determination on a day certain to be therein named, a full and complete transcript of the record and all proceedings in the case numbered and entitled on its docket, No. 20909, *Leonard H. Carter, Trustee of Union Fabrics, Inc., Bankrupt, Trustee-Appellee* v. *United States of America and State of New York, Claimants-Appellants,* and that the said judgment of the Circuit Court of Appeals in the Second Circuit may be reviewed by this Court as prayed for by petitioner, and that your petitioner may have such other and further relief in the premises as to this Honorable Court may seem meet and just.

Dated, July 13, 1948.

NATHANIEL L. GOLDSTEIN,
Attorney General of the State of New York;
By: WENDELL P. BROWN,
Solicitor General of the State of New York,
Attorney for Petitioner.

APPENDIX

UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT.

No. 267—October Term, 1947.

(Submitted May 3, 1948—Decided May 25, 1948).

Docket No. 20977

LEWIS H. SHAPER, as Trustee in Bankruptcy of SPOTLIGHT PRODUCTIONS, INC., *Petitioner-Appellant,*

v.

THE CITY OF NEW YORK, *Respondent-Appellee.*

Before: L. HAND, SWAN and CLARK, *Circuit Judges*

Appeal from the District Court of the United States for the Southern District of New York.

Petition by Lewis H. Saper, as trustee of Spotlight Productions, Inc., bankrupt, for review of an order of a referee in bankruptcy refusing to expunge the claim of the City of New York against the bankrupt for sales and business taxes and ordering the payment of the claim, together with interest at the rate of one per cent per month until the date of payment. From an order affirming the order of the referee, D.C., S. D. N. Y., 75 F. Supp. 458, the petitioner appeals. Order affirmed as to the principal of the taxes, but reversed as to the interest.

DAVID HAAR,
of New York City,
for appellant;

JOHN P. McGRATH,
Corp. Counsel, of New York City
(Isaac C. Donner, Bernard H. Sherris, and Leroy Mandle, all of New York City, of counsel), for appellee.

CLARK, *Circuit Judge:*

The first point on this appeal concerns the validity of a claim against an estate in bankruptcy for certain sales and business taxes levied by the City of New York against the bankrupt. The trustee concedes the validity of such taxes as were levied upon the bankrupt's sales of machinery manufactured by it, but contests the tax levied on its purchases of materials. But, as stated in the opinion below, D. C. S. D. N. Y., 75 F. Supp. 458, this is directly contrary to the law and the rulings under it. It is quite settled that both seller and purchaser may be held liable for the city sales tax, though in fact it is primarily imposed upon the purchaser, who must pay it to the City Treasurer if he has failed to pay it to his vendor. § N41-2.0, subds. e, f, of the Administrative Code, New York City. *Kesbeck, Inc.* v. *McGoldrick*, 278 N.Y. 293, 297, 16 N.E. 2d 288, 119 A. L. R. 536, reargument denied 278 N.Y. 716, 17 N. E. 2d 136; *Fifth Ave. Bldg. Co.*, v. *Joseph*, 272 App. Div. 449, 71 N. Y. S. 2d 566; *City of New York* v. *Feiring*, 313 U.S. 283. The liability of the estate is clear.

The other point, however, the liability of the estate for interest upon these tax claims after bankruptcy and until they are paid, is interesting, important, and difficult. Both the referee and the district court have allowed interest, at the high rate provided by the local code of one per cent per month, so that the accumulating interest is fast approaching the face of the claim.[1] The decision must affect all tax claims in bankruptcy, from those of the federal government to those of any state or subdivision thereof. The matter has been in dispute and must remain so until settled by the Supreme Court. As will appear, the members of this court are not in accord as to the result to be reached. The court as presently constituted is agreed

[1] The tax period involved was Nov. 1, 1940 to May 31, 1942; the petition in bankruptcy was filed Jan. 5, 1944, and the City's claim originally on May 19, 1944; the referee's order of allowance was made on July 18, 1947. In that order he allowed a sales tax of $495.61, with interest to date of $341.97, and a business tax of $19.72, with interest of $13.13, and made express provision for additional interest at the rate of 1% per month until payment.

that Judge Coxe's decision, D. C. S. D. N. Y., 75 F. Supp. 458, should be reversed. His decision, however, was in accord with *Davie* v. *Green*, 1 Cir., 133 F. 2d 451 (which had reversed a referee and a district judge), and has the support of some other district court opinions, e.g., *In re Flarton*, D. C. E. D. N. Y., 42 F. Supp. 1002; and *cf. In re L. Gendolfi & Co.*, D. C. S. D. N. Y., 42 F. Supp. 706. It is contrary to the decision of Judge Bright in *In re Union Fabrics*, D. C. S. D. N. Y., 73 F. Supp. 685, the appeal from which is decided herewith,[2] with the writer of this opinion alone of the court there sitting in agreement with Judge Bright. Our decision herein was perhaps somewhat foreshadowed by the remarks of Judge L. Hand in *Hammer* v. *Tuffy*, 2 Cir., 145 F. 2d 447, 449, leaving the question open, and by those of Judge Swan in *United States* v. *Roth*, 2 Cir., 164 F. 2d 575, pointing out that under the recent congressional enactments tax claims were treated substantially as debts of the bankrupt. It is in accord with the views of text writers, notably Messrs. Moore and Oglebay, 3 Collier on Bankruptcy, 14th Ed. 1941, par. 63.16, reiterated in 1946 Com. Supp. 131, 132, also Mr. Oglebay in 17 J. N. A. Ref. Bankr. 127, 129, 130, 21 *id.* 106, 107, 22 *id.* 41, and the commentator in 61 Harv. L. Rev. 354.

For reasons both of administrative convenience and of fundamental justice and equity it has been steadily held, following the English practice, that interest does not accrue upon claims during the period of bankruptcy administration. *Sexton* v. *Dreyfus*, 219 U. S. 339, 344; *Vanston Bondholders Protective Committee* v. *Green*, 329 U. S. 156, 163, 165; 3 Collier, *loc. cit. supra*.[3] A single exception, that for tax claims, was developed judicially. It appears to have begun with *In re Kallak*, D. C. N. D., 147 F. 276, though the contemporaneous case of *In re William F. Fisher & Co.*, D. C. N. J., 148 F. 907, held to the contrary.

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[2] *Carter, Trustee* v. *United States, et al.*, 2 Cir., — F. 2d —.

[3] If, however, a sufficiency of assets develops, the claims will bear interest; and though the usual rule applies also to secured claims, yet where the security itself yields interest or dividends, those are applicable to interest on the claims. 3 Collier, *loc. cit. supra*.

But the Kallah case set the pattern and was followed by other cases, including *In re J. Nemist & Co.*, 2 Cir., 290 F. 947, which, however, allowed interest only at the legal rate. When the Supreme Court reversed this holding to allow interest at the statutory rate, though without separate discussion of our particular problem, *United States* v. *Childs*, 1924, 266 U. S. 304, the matter was considered settled. The reason for the rule was that the original Bankruptcy Act treated tax claims quite differently from other debts; instead of requiring their presentation in due course, it provided that "the court shall order the trustee to pay all taxes legally due and owing by the bankrupt to the United States, State, county, district, or municipality in advance of the payment of dividends to creditors." § 64a, 11 U. S. C. A. § 104 (a) (before amendment). Hence the trustee was, in effect, compelled to search them out. So taxes were in altogether a separate class; they were to be paid before any administration of the estate, properly speaking, and thus had an absolute priority over the bankrupt's debts. In view of this peculiarly favored position, the like result as to interest was certainly not unnatural, even if not compelled.

In 1926, however, § 64a was amended, by adding the words "in the order of priority as set forth in paragraph (b)"; and of the seven priorities provided in (b), taxes came sixth or next to the last. Even that change might have been considered sufficient to reduce taxes to the status of debts in view of the obvious doubt as to the payment of interest upon a sixth claim in a series where the earlier five admittedly carried none. Moreover, § 64b spoke of the debts "to have priority" in advance of the payment of dividends to creditors, "and to be paid in full out of bankrupt estates," in the order then stated; it was at least odd to think that a wage claim up to $600 was "paid in full" when paid without interest, whereas a tax claim of later priority was not so paid until interest of 12 per cent or more was included.[4] But the issue did not come before the Supreme Court; and apparently the lower

[4] For the meaning of "paid in full" as limited to the principal, see *Hammer* v. *Tuffy*, *supra*, 145 F. 2d at page 449.

federal courts continued their former practice. *Cf. Horn v. Boone County Neb.*, 8 Cir., 44 F. 2d 920; *In re Semon*, D. C. Conn., 11 F. Supp. 18, modified on other grounds 2 Cir., 80 F. 2d 81.

At any rate the process of assimilation of tax claims to other debts appears, to us at least, to have been completed by the Chandler amendments of 1938. Indeed we thus described the changes in *United States v. Roth, supra*, 164 F. 2d at pages 577, 578: "By the 1938 amendments, however, taxes were classified as 'debts' within section 64, sub. a. 11 U. S. C. A. § 104, sub. a, and section 57, sub. n, 11 U. S. C. A. § 93, sub. n, was broadened to include 'all claims of the United States' and require them to 'be proved and filed in the manner provided in this section.'[5] Subdivision a of section 57, 11 U. S. C. A. § 93, sub. a, provides that a proof of claim shall state among other matters 'that the claim is justly owing from the bankrupt to the creditors'; * * * Thus it is apparent that the Act, as it now stands, treats the tax claim as a debt and the United States as a creditor which like other creditors, must make proof of claim on a form" prescribed by the Supreme Court. This, then, took from tax claims their former favored position where no proof or other governmental action was necessary for their enforcement. Thenceforth they must be proved, or otherwise be barred, just like other debts of the bankrupt.

We see no reason to suppose that this did not place tax claims in the same situation as other debts with respect to interest also.[6] The chief ground taken in *Davis v. Green*,

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[5] In addition, by these amendments the priority subdivision formerly § 64b became § 64a, and the classes or priorities were changed to five instead of seven, the status of tax claims being still next to the last or (4) instead of (6). This was no advancement in position, since former classes (1), (2), and (3) were combined with (1). In 1946, there was added to (1) "the fees for the referees' salary fund and for the referees' expense fund." [This note is not a part of the quotation.]

[6] By making a tax claim a debt of the bankrupt it is brought within the terms of § 63a, 11 U. S. C. A. § 103(a), defining provable debts, of which subd. (1) allows interest only up to the filing of the petition, and subd. (5) includes provable debts reduced to judgment after filing, but less costs incurred and interest after the filing. Hence under subd. (5),

supra, and the other cases which argue for the priority of interest, as well as principal, though conceding its inequity, is that Congress by failing to exclude it has re-enacted the old rule. It is dubious at best to rely upon such congressional adoption where "a close scrutiny of the various reports and hearings on the Chandler Act or its predecessor bills reveals nothing to indicate that the problem was ever under consideration." 3 Collier on Bankruptcy, 1946 Cum. Supp., at n. 28a of par. 63.16; 61 Harv. L. Rev. 354. But it is submitted with deference that the pinch is on the other foot. When Congress provided that taxes must be proven like other debts and put them in, and well down in, a hierarchy of other claims, none of which bore interest, we think that like treatment was intended unless some specific exception was stated. This seems all the more likely when we recall the dubious and uncertain history of the original judicial exception.

This conclusion seems to us fortified by arguments of practicality and convenience—if not of equity, as stressed by Judge Bright—which would naturally appeal to legislators or draftsmen, if a careful exploration of the subject is to be attributed to them. Of course, the allowance of accruing interest to these various state and governmental units "would necessitate constant rescheduling and recomputation of dividends available." 61 Harv. L. Rev. 354, 355. And the net result will be to promote tax claims beyond what seems the clear intent of the statute.[7] Moreover, with the very heavy interest rates now collected by states and municipalities and upheld in *Meilink v. Unemployment Reserves Commission of State of California*,

when a tax claim is reduced to judgment after the filing, interest must be deducted. This points up the anomaly of another rule for tax claims not reduced to judgment.

[7] Assume a bankrupt to owe $1,000 to an employee for wages, $1,000 each to three taxing authorities, and $1,000 for rent given priority under state law. Under § 64a, which gives priority to the amount of $600 for wages and allows the others in order, these would be all paid in full if the assets were $5,000 and there were no other general claims beyond the $400 balance on the wage claim. But with interest allowed on the tax claims at 12% (or perhaps more) per annum during the bankruptcy, possible payments on the later claims would diminish in size as rapidly as Alice in Wonderland.

314 U. S. 564, it is apparent that any bankrupt estate whose settlement is delayed for any period of time is likely to be eaten up by the accruing interest on the various taxes now levied against business enterprises. As Referee Hunt points out, 17 J. N. A. Ref. Bankr. 121, 122, no trustee can afford to resist any tax claims, even with proper defenses. With interest accruing thus rapidly, he must settle at once and stop the increase in amount. True, it is suggested that this will be a boon to failing debtors who otherwise might be forced to the wall by rapacious tax collectors driven to precipitous action because the claims do not bear interest. But this is based upon an assumption both of alertness upon the part of taxing officials and of the importance of this lone item in the tax structure of municipalities and the state and federal governments which seems to us to have little connection with reality.

Two further arguments of claimants must be noted. One is as to § 57j, an old provision of the law stating that debts owing the United States or any State or subdivision thereof as a penalty or forfeiture shall not be allowed, except for the amount of pecuniary loss sustained "and such interest as may have accrued thereon according to law." Whether this has any meaning beyond the penalty or forfeiture cases we do not need to consider, for it seems clearly to be operable only *after* the question as to what, of any, interest is legal has been decided.[8] The other is that, since tax claims, if unpaid, are not discharged in bankruptcy, then the unpaid interest on tax claims will survive against the bankrupt even after payment of the tax claims themselves. No cases appear yet to have held that interest thus survives beyond the principal claim which gives it birth. But assuming *arguendo* that interest is not discharged upon payment of the tax claim, we do not see

[8] In the companion case, the United States devotes much attention to various of the federal revenue laws and congressional debates as to changes in them with respect to interest against estates held by fiduciaries. But these do not offer any clear-cut solutions in themselves and are hardly available to change the stated priorities of a bankruptcy act. Obviously the intent of the latter is to treat federal, state, and municipal tax claims alike; it would be quite improper to accord the former alone some advantage based upon some newly discovered other federal law or regulation.

how that fact can be decisive on the present issue. When the Chandler Act was under consideration, the House bill made taxes dischargeable, while the Senate amendment retained existing law. Sen. Rep. No. 1916, 75th Cong., 3d Sess., 4, stated that the committee felt "that if Federal taxes were made dischargeable, it would open the door to evasion. The Treasury Department recommended against the House amendment." Thus this was done to protect the revenue, and consideration for, or against, the bankrupt was not an issue. The fact that the bankrupt may not have received an immunity he might desire is not ground for upsetting the statutory scheme of distribution of the estate in the hands of the trustee. The point is academic here—as it will often be—since the bankrupt is a corporation whose existence will be brought to an end by the bankruptcy.

Accordingly the order on appeal will be affirmed to the exent that it refuses to expunge the tax claims, but will be reversed so far as it allows interest after the filing of the petition on January 5, 1944.

Order affirmed in part and reversed in part.

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1948

No. 200

IN THE MATTER OF
UNION FABRICS, INC.,
Bankrupt,

STATE OF NEW YORK,
Petitioner,

v.

LEONARD H. CARTER, TRUSTEE IN BANKRUPTCY,
Respondent.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

I

Opinions Below

The opinion of the District Court is reported in 73 Fed. Supp. 685, and is to be found at page 19 of the record. The opinion of the Circuit Court of Appeals for the Second Circuit is to be found at page 41 of the record. It has not been officially reported at the time of the preparation of this brief.

II

Jurisdiction

The date of the judgment to be reviewed is May 25, 1948 (R. 45).

The jurisdiction of this Court is invoked under § 240 of the Judicial Code [28 U. S. C. A. § 347].

III

Statement of the Case

The essential facts of the case are stated in the accompanying petition for a writ of certiorari, and in the interest of brevity are not repeated here.

IV

Specification of Errors

The Circuit Court of Appeals erred in disallowing interest on the tax claims of the State of New York to the date of payment thereof, and in holding that such tax claims carry interest only to the date of the filing of the petition in bankruptcy.

V

ARGUMENT AND AUTHORITIES IN SUPPORT OF PETITION

Summary of the Argument

POINT A

The State of New York is entitled to interest on its claims for franchise and unemployment insurance taxes to the date of payment of the claims. The amendments

to §§ 57 (j), 57 (n) and 64 (a) of the Bankruptcy Act, as contained in the Chandler Act, did not change the previously existing rule that tax claims carry interest to the date of payment.

Point B

Evidence that the trustee in bankruptcy was engaged in litigation over a period of years, which resulted in an increase in the value of the assets of the bankrupt estate, is immaterial on the question whether interest on tax claims is payable to the date of payment. The question presented is one of law and not of equity.

Point A

It cannot be disputed that prior to the amendment of the Bankruptcy Act by the Chandler Act in 1938, tax claims carried interest to the date of payment.

Dayton, Trustee v. *Stannard, Treasurer, etc.* (1946), 241 U. S. 588;

People of the State of New York v. *Jersawit, Trustee* (1923), 263 U. S. 493;

United States v. *Childs* (1924), 266 U. S. 304;

Horn v. *Boon County, Nebraska* (1930, C. C. A. 8), 44 Fed. (2d) 920;

Matter of Beardsley & Wolcott Mfg. Co. (1936, C. C. A. 2), 82 Fed. (2d) 239;

Matter of Martin (1935, C. C. A. 7) 75 Fed. (2d) 618.

It is not apparent from the Chandler Act amendments to § 64 (a) [11 U. S. C. A. § 104 (a)] and § 57 (n) [11 U. S. C. A. § 93 (n)], or from the Congressional Reports or debates on the Chandler Act amendments, that Congress ever intended to change the long established rule with respect to the payment of interest on tax claims. The amendments to those sections were for the purpose of facilitating the prompt and orderly administration of bankrupt estates. Section 57 (j) of the Bankruptcy Act [11 U. S. C. A. § 93 (j)] has remained unchanged since the original bankruptcy

act was passed in 1898, except that the words "state, county, district or municipality" were taken out and the words "or any state or subdivision thereof" inserted in their stead by the Chandler Act. It was under § 57 (j) that this Court held in *United States* v. *Childs*, 266 U. S. 304, that taxes carry interest to the date of payment. In *Medink* v. *Unemployment Reserves Commission of California*, 314 U. S. 564, this Court held that interest at the rate of 12% per annum, as prescribed by the California Unemployment Compensation Act, on California's claim for unemployment compensation taxes was "* * * such interest as may have accrued thereon according to law," within the meaning of § 57 (j), *supra*, and not a penalty within the meaning of that section. The Circuit Court of Appeals for the First Circuit in *Davis* v. *Grech*, 133 Fed. (2d) 451, has also held that the Chandler Act amendments did not change the long existing rule. This latter decision is in direct conflict with the opinion of the Second Circuit Court of Appeals in the instant case, and in *Saper* v. *City of New York*: — Fed. (2d) — (decided May 25, 1948).

That Congress, by the Chandler Act, did not intend any change in the previously existing rule is conclusively shown by the fact that on June 8, 1948, the House of Representatives passed a bill introduced by Congressman Reed (H. R. 5693; 80th Congress, 2d Session), by which it is intended to amend the Bankruptcy Act in several respects. Section 11 of that bill provides for the amendment of § 57 (j) of the Bankruptcy Act to read as follows:

> "Sec. 11. (a) Subdivision j of section 57 of such Act, as amended, is amended to read as follows:
>
> "'j. (1) Debts owing to the United States or to any State or any subdivision thereof as a penalty or forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained by the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interest as may have accrued on the amount of such loss up to the date of bankruptcy.
>
> "'(2) Except where the estate of the bankrupt is solvent, interest accruing after the date of bankruptcy

on taxes legally due and owing to the United States or to any State or any subdivision thereof shall not be allowed.'"

This bill was referred to the Senate Committee on the Judiciary on June 9, 1948, but no action thereon had been taken up to the time of the recent adjournment of Congress.

The introduction of this bill indicates conclusively that the Chandler Act amendments were not intended to deprive the sovereigns of interest on the tax claims to the date of payment. If such had been the previous Congressional intent, an amendment to accomplish that result would have been enacted many years ago, since Congress is presumed to have knowledge of the long line of cases granting such interest.

If this bill becomes law it will not make academic the question presented here, since §31 of the bill provides:

> "Sec. 31. Effect of this Amendatory Act.—(a) Nothing herein contained shall have the effect to release or extinguish any penalty, forfeiture, or liability incurred under any Act or Acts of which this Act is amendatory."

The State of New York, acting within its constitutional sphere, has established the measure of the delinquency of the bankrupt with respect to the franchise and unemployment insurance taxes involved herein. New York Unemployment Insurance Law §570, subd. 3 (Labor Law Art. 18) provides that if an employer shall default in any payments required to be made by him to the unemployment insurance fund before July 1, 1947, interest upon the amount determined to be due shall be payable at the rate of 6% per annum from the date prescribed for payment and shall be collected as a part of the payment required to be made by the employer to the fund. This is the section which applies to the unemployment insurance taxes involved in this proceeding, since they were payable prior to July 1, 1947, and covered the period January 1, 1936 to November 28, 1939. A copy of §570, subds. 1-4 of the New York Unemployment Insurance Law is attached hereto as an appendix.

Similarly, the Legislature of New York has established the measure of delinquency of the bankrupt with respect to franchise taxes, as set forth in New York Tax Law 213, copy of which is appended hereto. Accordingly, the State of New York is entitled to interest to the date of payment of the tax claims, since Bankruptcy Act 57(j) provides for the payment of "such interest as may have accrued thereon according to law." Interest has accrued on these claims according to the law of the State of New York.

Point B

The District Court, in reversing the order of the referee herein, held that the referee should have considered the equities presented by the record in determining whether interest should be allowed to the date of payment (R. 25), and that "the allowance of interest to the date of payment, an accumulation caused solely because of delays necessitated by the successful efforts of the Trustee to protect and increase the estate, seems to me to be entirely inequitable and to result in an unbalance of equities between the several creditors rather than a 'balance of equities' which the Supreme Court says is the touchstone of each decision."

This statement was apparently prompted by the language of this court in *Vanston Bondholders Protective Committee v. Green, et al.*, 329 U. S. 156. In that case tax claims were not involved. The question presented there was whether the creditors holding first mortgage bonds, which provided for the payment of "interest on interest" should receive such interest. If so, subordinate creditors would receive a greatly reduced share in the reorganized corporation. This court held that the imposition of "interest on the unpaid interest" cannot be justified by an application of equitable principles. These subordinate creditors, however, conceded that the holders of the first mortgage bonds should receive simple interest on the principal due them.

There is no question here that the State's claims were filed timely, nor is there any assertion that any action or inaction on the part of the State caused a delay in the payment of claims. The claims were filed in 1940. The assets of the estate, prior to the receipt of the sum of $30,000 in

settlement of the claim of the trustee against the bankrupt's former president, were $19,888.11 in cash and a small amount of merchandise (R. 8). This was more than sufficient to pay the entire priority claims of the United States and the State of New York in the principal sum of $11,526.27 (R. 7), with interest which had accrued to the time of the filing of the claims, amounting to $1,233.59, as well as the amount which was paid to the City of New York in compromise of its tax claim in the sum of $3,564.70, amounting in all to the sum of $16,324.56. After the payment of these tax claims, there would have still remained in the estate the sum of $3,563.55. The trustee, however, chose to let these tax claims remain unpaid until the litigation, which lasted approximately six years, was concluded (R. 6-8). Under these circumstances, there is nothing in this case to charge the State with the delay in payment of its claims and thus justify the court in denying interest on asserted equitable grounds.

In *Pepper* v. *Litton*, 308 U. S. 295, this Court held that bankruptcy courts have certain equitable powers in passing on a wide range of problems arising out of the administration of bankrupt estates. "These [these equitable powers] have been invoked to the end that fraud will not prevail, that substance will not give way to form, that technical consideration will not prevent substantial justice from being done" (p. 304). The instant case, so far as the tax claims are concerned, does not fall within any of these categories to which bankruptcy courts may apply equitable powers. Courts may not invoke "a balance of equities" when such action would be clearly contrary to the statutory mandate (*New Jersey* v. *Anderson*, 203 U. S. 483, 490).

Conclusion

It is respectfully submitted that this case calls for the exercise by this Court of its supervisory power. The subject matter of this petition is of great importance because it affects the administration of innumerable bankrupt estates. If the conflict in opinion between the Circuit Courts of Appeals for the First and Second Circuits continues to exist, the expeditious closing of many bankruptcy

proceedings will be forestalled by the uncertainty created thereby. This Honorable Court should resolve this difference of opinion so that bankruptcy referees throughout the country will have no uncertainty as to the law on the subject.

Dated, July 13, 1948.

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Albany, N. Y.
By WENDELL P. BROWN,
Solicitor General of the State of New York,
Attorney for Petitioner.

APPENDIX

New York Tax Law §213:

"* * * If any part of any tax imposed by this article is not paid when due, the taxpayer shall pay to the tax commission, in addition to the amount of such tax, five per centum of such unpaid amount, plus one per centum for each month the tax remains unpaid. The tax commission in its discretion may modify the penalties or additional amounts provided in this article without regard to whether such penalties or additional amounts have been included in a statement of account or an application for revision of such account has been filed."

New York State Unemployment Insurance Law (Labor Law, Artice 18)—§570, subds. 1, 2, 3 and 4:

"Payment of Contributions. 1. Rate. Each employer liable under this article shall pay regularly contributions in an amount equal to two and seven-tenths per centum of his payroll.

"2. Time and method of payment. Contributions shall become payable by any employer for wages paid on and after the date on which he becomes liable under this article. All contributions from employers shall be paid at such times and in such manner as the commissioner may prescribe.

"3. Default before July first, nineteen hundred forty-seven. If an employer shall default in any payments required to be made by him to the fund before July first, nineteen hundred forty-seven, interest upon the amount determined to be due from the employer shall be payable upon notice and demand from the commissioner at the rate of six per centum per annum from the date prescribed for payment and shall be collected as a part of the payment required to be made by the employer to the fund.

"If any part of any deficiency in payment of the employer's contribution to the fund before July first, nineteen hundred forty-seven is due to negligence but

without intent to defraud, five per centum of the total amount of the deficiency, in addition to such deficiency, shall be assessed, collected, and paid in the same manner as if it were a deficiency.

"4. Default on and after July first, nineteen hundred forty-seven. An employer who fails to pay contributions required to be made by him to the fund on or after July first, nineteen hundred forty-seven, shall pay interest at the rate of three-fourths of one per centum of the amount of such contributions for each month, or fraction thereof, he is in default. Such interest shall be assessed, collected and paid as part of the payment required to be made by the employer to the fund."

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SUPREME COURT U.S

IN THE

Supreme Court of the United States

OCTOBER TERM, 1948.

No. 200

STATE OF NEW YORK, *Petitioner,*

vs.

LEONARD H. CARTER, as Trustee in Bankruptcy.

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR THE STATE OF NEW YORK, PETITIONER

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Question Presented

The question presented here is whether the claims of the State of New York for corporate franchise taxes and unemployment insurance taxes against the estate of the bankrupt are entitled to carry interest to the date of the payment of the claims or to the date of the filing of the petition in bankruptcy only.

Statutes Involved

The pertinent statutes are set forth in the appendix, *infra*, pp. 14-17.

Statement

An involuntary petition in bankruptcy was filed against Union Fabrics, Inc., on December 20, 1939 (R. 4). The State of New York filed a tax claim for corporation franchise taxes under Article 9-A of the Tax Law of the State of New York for the years 1936, 1937 and 1938, in the sum of $1,403.14, and for unemployment insurance taxes covering the period January 1, 1936 to October 28, 1939, in the sum of $257.78 (R. 18). These claims asked for interest to the date of payment of the same (R. 6). By notices dated July 1 and July 2, 1946, the trustee in bankruptcy filed objections to the demand for interest on these claims beyond the date of the filing of the petition in bankruptcy (R. 3). After consolidated hearings, the referee in bankruptcy, on January 24, 1947, filed separate findings of fact and conclusions of law, and on the same date filed a consolidated memorandum overruling the trustee's objections to the allowance of interest to the date of payment, and entered orders to that effect (R. 19-21). Thereafter, the referee reopened the proceeding for the purpose of hear-

ing a further objection of the trustee based upon certain alleged equitable considerations, but sustained the objections to this evidence and made an order to that effect (R. 22-27). Upon the petition for review, the District Court reversed the order of the referee allowing interest on the tax claims to the date of payment and sustaining objections to the trustee's offer of proof at the hearing (R. 11-17). The District Court held that interest on tax claims of the State of New York should be treated in the same manner as interest on other claims and not allowed beyond the date of the filing of the petition (R. 13-17). The District Court also held that the evidence presented with respect to the cause of the long delay in the administration of the estate, if pertinent to the determination, was sufficiently shown by the records of the court to supplement other reasons for the denial of the interest (R. 17).

The court below affirmed the order of the District Court upon the authority of *Saper* v. *City of New York*, 168 F. (2d) 268, decided on the same day the instant case was decided.

Two of the three judges who sat in the instant case did not agree with the three judges who sat in the *Saper* case, nor with the decision of the District Court. They felt bound, however, to follow the decision of the court on this question in the *Saper* case. The two judges in the Circuit Court, who were of the opinion that the State's tax claims are entitled to interest to the date of payment, expressed their personal views on the subject in their opinion. These views are in accord with those of the First Circuit in *Davis* v. *Green*, 133 F. (2d) 451 (R. 28-31).

Specification of Errors to be Urged

The court below erred:

(1) In holding that interest on tax claims of the State of New York should be allowed only to the date of the filing of the petition in bankruptcy; and

(2) In affirming the order of the District Court.

Summary of Argument

The argument that follows may be briefly summarized:

I.

The State of New York is entitled to interest on its claims for franchise and unemployment insurance taxes to the date of payment of the claims. The amendments to §§ 57 (j), 57 (n) and 64 (a) of the Bankruptcy Act, as contained in the Chandler Act did not change the previously existing rule that tax claims carry interest to the date of payment.

II.

Evidence that the trustee in bankruptcy was engaged in litigation over a period of years, which resulted in an increase in the value of the assets of the bankrupt estate, is immaterial to the question whether interest on tax claims is payable to the date of payment of the claims. The question presented is one of law and not of equity.

ARGUMENT

I

The amendments to the Bankruptcy Act by the Chandler Act in 1938 did not change the previously existing rule that tax claims against a bankrupt estate carry interest to the date of payment.

It cannot be disputed that, prior to the amendment of the Bankruptcy Act by the Chandler Act, tax claims carried interest to the date of payment.

Dayton, Trustee v. *Stanard, Treasurer, etc.* (1916), 241 U. S. 588;

People of the State of New York v. *Jersawit, Trustee* (1924), 263 U. S. 493;

United States v. *Childs* (1924), 266 U. S. 304;

Horn v. *Boone County, Nebraska*, (1930, C. C. A. 8), 44 Fed. (2d) 920;

Matter of Beardsley & Wolcott Mfg. Co. (1936, C. C. A. 2), 82 Fed. (2d) 239; and

Matter of Martin (1935), C. C. A. 7), 75 Fed. (2d) 618.

In the foregoing cases, interest on tax claims to the date of payment was allowed under the authority of § 57 (j) of the Bankruptcy Act. That section has remained unchanged since the original Bankruptcy Act was passed in 1898, except that the words "state, county, district or municipality" were taken out and the words "or any state or subdivision thereof" inserted in their stead by the Chandler Act. This change, of course, is immaterial to the question presented here.

The members of the court below, who heard the case of *Saper, etc.* v. *The City of New York*, 168 F. (2d) 268, de-

cided on the same day the instant case was decided, and which constituted the authority for the decision in the instant case, felt that the reason for the rule providing for interest to the date of payment was that the original bankruptcy act treated tax claims quite differently from other debts, that § 64 (a) [11 U.S.C.A. § 104 (a)] ordered the trustee to pay all taxes legally due and owing by the bankrupt to the United States, state, county, district or municipality in advance of the payment of dividends to creditors, and that the trustee was compelled to search out the tax creditors and pay their claims. The court, in the *Saper* case, concluded, further, that by the amendment to § 64 (a) in 1926 (c. 406, § 15, 44 Stat. 666), which added the words "in the order of priority as set forth in paragraph (b)," and which placed tax claims next to last, and by the amendment to §64 (b), which spoke of the "debts to have priority" in advance of the payment of dividends to creditors "and to be paid in full out of bankrupt estates," in the order then stated, Congress evinced an intention to remove tax claims from the priority theretofore accorded them. The court felt that even if these changes were not sufficient to alter the previously existing rule with reference to the payment of interest, the amendments to § 64 (a) [11 U.S.C.A. § 104, sub. a] and § 57 (n) [11 U.S.C.A. § 93, sub. n] by the Chandler Act, wherein § 57 (n) was broadened to include all claims of the United States and of any State or subdivision thereof, and required them to be proved and filed in the manner provided by that section, certainly accomplished that result. The court felt that the Bankruptcy Act, as it now stands, treats tax claims as debts and the sovereign as a creditor which must make proof of its claim the same as other creditors, and that this took from tax claims their former favored position.

We cannot agree with the court's reasoning that the amendments referred to in any way changed the existing rule. These amendments were for the purpose of facilitating the prompt and orderly administration of bankrupt estates, as noted by Judge Augustus N. Hand in the instant case below (R. 31). It is not apparent from the Chandler Act amendments to § 64 (a) [11 U.S.C.A. § 104 (a)] and 57 (n) [11 U.S.C.A. § 93 (n)], or from the Congressional Reports or debates on the Chandler Act amendments, that Congress ever intended to change the long established rule for payment of interest on tax claims. We believe that the reasoning of the Circuit Court of Appeals for the First Circuit in *Davis* v. *Green*, 133 F. (2d) 451, is sound, and that Congress would not have made such a far-reaching change as would result in reversing the prior interpretation without clear and specific language to that effect. In fact, after the amendments of 1926 and before the enactment of the Chandler Act in 1938, the courts had consistently adhered to the long established rule.

Horn v. *Boone County Neb.* (1930, C.C.A. 8), 44 F. (2d) 920;
Matter of Semon, (1935, C.C.A. 2), 80 F. (2d) 81;
Matter of Martin, (1935, C.C.A. 7), 75 F. (2d) 618;
Matter of Beardsley & Wolcott Mfg. Co., (1936, C.C.A. 2), 82 F. (2d) 239; and
Matter of Standard Composition Co., (1938, D.C. E.D. Mich.), 23 F. Supp. 391.

As bearing on the question whether Congress intended by the Chandler Act to change the rule, we refer to the decision of Referee Friebolin in *Matter of D. O. Summers Co., Bankrupt*, 45 Am. B.R. [N.S.] 123, decided in 1939, wherein he held that tax claims carry interest to the date of payment after the enactment of the Chandler Act. In that case the referee stated (p. 129):

> "Until some decision is rendered directly upon this point by the Supreme Court or a Court whose decision is binding upon me, I am constrained to conclude that interest upon taxes should be allowed to date of payment."

We consider this statement of Referee Friebolin to be highly significant in view of the fact that he was one of the principal draftsmen of the Chandler Act (Collier on Bankruptcy, 14th Ed., Vol. 3, 1946 Cum. Supp., Note 28a, pp. 1843 and 1844). This decision constitutes very strong evidence that Congress did not intend to change the existing rule by any amendment contained in the Chandler Act. If such a change had been intended by Congress, Referee Friebolin would have known about it.

But we think the best evidence of the fact that Congress, by the amendments of 1926 and the Chandler Act amendments of 1938, did not intend any change in the existing rule regarding the payment of interest on tax claims, is the fact that on June 8, 1948, the House of Representatives passed a bill, introduced by Congressman Reed (H. R. 5693, 80th Congress, 2d Session), by which it was intended to amend the Bankruptcy Act in several respects. Section 11 of the bill provided for the amendment of § 57 (j) of the Bankruptcy Act to read as follows:

> "Sec. 11. (a) Subdivision j of section 57 of such Act, as amended, is amended to read as follows:
>
> "'j. (1) Debts owing to the United States or to any State or any subdivision thereof as a penalty or forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained by the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interest as may have accrued on the amount of such loss up to the date of bankruptcy.
>
> "'(2) Except where the estate of the bankrupt is solvent, interest accruing after the date of bankruptcy

on taxes legally due and owing to the United States or to any State or any subdivision thereof shall not be allowed.'"

The bill was referred to the Senate Committee on the Judiciary on June 9, 1948, but no action thereon had been taken up to the time of the adjournment of Congress on June 20, 1948. The report of the House Committee on the Judiciary, which recommended the amendment, clearly indicates its understanding that prior to its introduction no previous amendments to the Bankruptcy Act had changed the rule that tax claims carry interest to the date of payment. This report (No. 2083) states as follows (p. 5):

"Section 11 (a) of the bill is intended both to clarify and modify section 57j of the act. The change in 57j (c) is to make clear that the limitation on interest 'up to the date of bankruptcy' relates only to interest on the 'pecuniary loss,' and further that such interest stops at the date of bankruptcy. The addition of clause (2) in the bill is intended to overrule an obsolete rule as to interest on delinquent tax debts. Interest on general unsecured debts, on unsecured Government debts other than taxes, and on debts entitled to priority under section 64a, is suspended at the date of bankruptcy so that, except in the rare case of a solvent estate, interest is allowable only to such date. (Sec. 63a; *Adams* v. *Napa Cantina Wineries* (C. C. A., 9th Cir.), 36 Am. B. R. (N. S.) 8; *In re Gandolfi & Co., Inc.* (S. D., N. Y.), 51 Am. B. R. (N. S.) 521 (governmental debts and other debts entitled to priority); *3 Collier on Bankruptcy*, 14th Ed., 1835 *et seq.*; *2 Remington on Bankruptcy*, 4th Ed., secs. 771, 795.) However, interest on delinquent tax debts is allowable to the date of payment (*In re Kallak* (D. C., N. D., 1906), 17 Am. B. R. 414; *In re Ashland Emery and Corundum Co.* (D. C., Mass., 1916), 36 Am. B. R. 194; *In re Clark Realty Co.* (C. C. A., 7th Cir., 1918), 42 Am. B. R. 403; *sub silentio, United States* v. *Childs*, 266 U. S. 304, 307 (1924), 5 Am. B. R. (N. S.) 5). Although, under the Chandler Act, a tax debt is required to be proved (sec. 57n) and its order of priority ranks below all administration costs and

expenses, wages and costs and expenses of creditors successfully opposing a settlement or discharge, or procuring a conviction for an offense (sec. 64a (1), (2), (3)), thereby rendering obsolete the reasoning in the *Kallak* case, nevertheless its rule has not been changed, and therefore requires this statutory modification. For further discussion see *In re D. O. Summers* (Ref., N. D., Ohio, 1939), 46 Am. B. R. (N. S.) 123; *In re Dorsey* (Ref., W. D., Wash., 1940), 46 Am. B. R. (N. S.) 146; *Davis* v. *Green* (C. C. A., 1st Cir., 1943), 52 Am. B. R. (N. S.) 603. And on overruling the *Kallak* case see *In re Union Fabrics, Inc.*, (S. D., N. Y., 1947), 73 F. Supp. 685, appeal pending."

This report refers to the decision of the District Court in the instant case. Even in the face of that decision, Congress felt obligated to amend the statute so as to "clarify and modify section 57j of the act." The "clarification" was to make clear that the limitation on interest up to the date of bankruptcy relates only to interest on the "pecuniary loss" and that such interest stops at the date of bankruptcy. The "modification" was for the purpose of changing the rule with respect to the payment of interest on tax claims so that such interest would be payable to the date of the filing of the petition only. In order for this rule to be changed, the Bankruptcy Act "requires this statutory modification."

The officers of the State of New York who administer the Tax Law with respect to corporation franchise taxes and the Unemployment Insurance Law are required to seek collection of delinquencies established by the Legislature of the State of New York. The Legislature, acting within its constitutional sphere, has measured the amount of the delinquency in such cases (Tax Law § 213, Unemployment Insurance Law § 570, subds. 1, 2, 3 and 4, *infra*). Bankruptcy Act § 57 (j) provides for the payment of "such interest as may have accrued thereon according to law." Interest to

the date of payment has accrued on these claims according to the law of the State of New York (*Meilink* v. *Unemployment Reserves Commission of Cal.*, 314 U. S. 564).

H

The question presented is one of law and not of equity.

The District Court, in reversing the order of the referee herein, held that the referee should have considered the equities presented by the record in determining whether interest should be allowed to the date of payment (R. 17), and that "the allowance of interest to the date of payment, an accumulation caused solely because of delays necessitated by the successful efforts of the Trustee to protect and increase the estate, seems to me to be entirely inequitable, and to result in an unbalance of equities between the several creditors rather than 'a balance of equities' which the Supreme Court says is the touchstone of each decision" (R. 17).

There is no question here that the State's claims were filed timely, nor is there any assertion that any action or inaction on the part of the State caused a delay in the payment of claims. The claims were filed in 1940. The assets of the estate, prior to the receipt of the sum of $30,000 in settlement of the claim of the trustee against the bankrupt's former president, were $19,888.11 in cash and a small amount of merchandise (R. 6). This was more than sufficient to pay the entire priority claims of the United States and the State of New York in the principal sum of $14,526.27 (R. 5, 6), with interest which had accrued to the time of the filing of the claims, amounting to $1,233.59, as well as the amount which was paid to the City of New York in compromise of its tax claim in the sum of $3,564.70.

amounting in all to the sum of $16,324.56. After the payment of these tax claims, there would have still remained in the estate the sum of $3,563.55. The trustee, however, chose to let these tax claims remain unpaid until the litigation, which lasted approximately six years, was concluded (R. 4-7). Under these circumstances, there is nothing in this case to charge the State with the delay in payment of its claims and thus justify the court in denying interest on asserted equitable grounds.

In *Pepper* v. *Litton*, 308 U. S. 295, this Court held that bankruptcy courts have certain equitable powers in passing on a wide range of problems arising out of the administration of bankrupt estates. "They [these equitable powers] have been invoked to the end that fraud will not prevail, that substance will not give way to form, that technical considerations will not prevent substantial justice from being done" (p. 304). The instant case, so far as the tax claims are concerned, does not fall within any of these categories to which bankruptcy courts may apply equitable powers. Courts may not invoke a balance of equities when such action would be clearly contrary to the statutory mandate (*New Jersey* v. *Anderson*, 203 U. S. 483, 490).

Conclusion

For the above reasons, it is submitted that the judgment of the Circuit Court of Appeals should be reversed.

Dated: Albany, New York, November 17, 1948.

Respectfully submitted,

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APPENDIX

Bankruptcy Act of 1898, c. 541, 30 Stat. 544:

Sec. 57. PROOF AND ALLOWANCE OF CLAIMS.

* * *

j. [as amended by the Act of June 22, 1938, c. 575, 52 Stat. 840, Sec. 1]: Debts owing to the United States or any State or subdivision thereof as a penalty or forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained by the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interest as may have accrued thereon according to law.

* * *

n. [as amended by the Act of May 27, 1926, c. 406, 44 Stat. 662, Sec. 13; Act of June 22, 1938, c. 575, 52 Stat. 840, Sec. 1] Except as otherwise provided in this Act, all claims provable under this Act, including all claims of the United States and of any State or subdivision thereof, shall be proved and filed in the manner provided in this section. Claims which are not filed within six months after the first date set for the first meeting of creditors shall not be allowed: *Provided, however*, That the court, may upon application before the expiration of such period and for cause shown, grant a reasonable fixed extension of time for the filing of claims by the United States or any State or subdivision thereof: * * *.

(11 U. S. C. A., § 93.)

Sec. 64. DEBTS WHICH HAVE PRIORITY. [as amended by the Act of May 27, 1926, c. 406, 44 Stat. 662, Sec. 15; Act of June 22, 1938, c. 575, 52 Stat. 840, Sec. 1; Act of June 28, 1946, c. 512, 60 Stat. 323, Sec. 12]

a. The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be (1) the actual and necessary costs, and expenses of preserving the estate subsequent to filing the petition; the fees for the referees' salary fund and for the referees' expense fund; the filing fees paid by creditors

in involuntary cases; where property of the bankrupt transferred or concealed by him either before or after the filing of the petition, shall have been recovered for the benefit of the estate of the bankrupt by the efforts and at the cost and expense of one or more creditors, the reasonable costs and expenses of such recovery; the costs and expenses of administration, including the trustee's expenses in opposing the bankrupt's discharge, the fees and mileage payable to witnesses as now or hereafter provided by the laws of the United States, and one reasonable attorney's fee, for the professional services actually rendered, irrespective of the number of attorneys employed, to the petitioning creditors in involuntary cases and to the bankrupt in voluntary and involuntary cases, as the court may allow; (2) wages, not to exceed $600 to each claimant, which have been earned within three months before the date of the commencement of the proceeding, due to workmen, servants, clerks, or traveling or city salesmen on salary or commission basis, whole or part time, whether or not selling exclusively for the bankrupt; (3) where the confirmation of an arrangement or wage-earner plan or the bankrupt's discharge has been refused, revoked, or set aside upon the objection and through the efforts and at the cost and expense of one or more creditors, or, where through the efforts and at the cost and expense of one or more creditors, evidence shall have been adduced resulting in the conviction of any person of an offense under this Act, the reasonable costs and expenses of such creditors in obtaining such refusal, revocation, or setting aside, or in adducing such evidence; (4) taxes legally due and owing by the bankrupt to the United States or any State or any subdivision thereof: *Provided*, That no order shall be made for the payment of a tax assessed against any property of the bankrupt in excess of the value of the interest of the bankrupt estate therein as determined by the court: *And provided further*, That, in case any question arises as to the amount or legality of any taxes, such question shall be heard and determined by the court; and (5) debts owing to any person, including the United States, who by the laws of the United States in [*sic*] entitled to priority, and rent owing to a land

lord who is entitled to priority by applicable State law: *Provided, however*, That such priority for rent to a landlord shall be restricted to the rent which is legally due and owing for the actual use and occupancy of the premises affected, and which accrued within three months before the date of bankruptcy.

(11 U. S. C. A., § 104.)

New York Tax Law § 213:

* * * If any part of any tax imposed by this article is not paid when due, the taxpayer shall pay to the tax commission, in addition to the amount of such tax, five per centum of such unpaid amount, plus one per centum for each month the tax remains unpaid. The tax commission in its discretion may modify the penalties or additional amounts provided in this article without regard to whether such penalties or additional amounts have been included in a statement of account or an application for revision of such account has been filed.

New York State Unemployment Insurance Law (Labor Law, Article 18)—§ 570, subds. 1, 2, 3 and 4:

Payment of Contributions. 1. Rate. Each employer liable under this article shall pay regularly contributions in an amount equal to two and seven-tenths per centum of his payroll.

2. Time and method of payment. Contributions shall become payable by any employer for wages paid on and after the date on which he becomes liable under this article. All contributions from employers shall be paid at such times and in such manner as the commissioner may prescribe.

3. Default before July first, nineteen hundred forty-seven. If an employer shall default in any payments required to be made by him to the fund before July first, nineteen hundred forty-seven, interest upon the amount determined to be due from the employer shall be payable upon notice and demand from the commissioner at the rate of six per centum per annum from the date prescribed for payment and shall be collected as a part of the payment required to be made by the employer to the fund.

If any part of any deficiency in payment of the employer's contribution to the fund before July first, nineteen hundred forty-seven is due to negligence but without intent to defraud five per centum of the total amount of the deficiency, in addition to such deficiency, shall be assessed, collected, and paid in the same manner as if it were a deficiency.

4. Default on and after the July first, nineteen hundred forty-seven. An employer who fails to pay contributions required to be made by him to the fund on or after July first, nineteen hundred forty-seven, shall pay interest at the rate of three-fourths of one per centum of the amount of such contributions for each month, or fraction thereof, he is in default. Such interest shall be assessed, collected and paid as part of the payment required to be made by the employer to the fund.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1948

No. 201

UNITED STATES OF AMERICA, *Petitioner*

v.

LEONARD H. CARTER, TRUSTEE OF UNION FABRICS, INC., *Bankrupt*

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

The Solicitor General, on behalf of the United States, prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Second Circuit, entered in the above-entitled case on May 25, 1948.

OPINIONS BELOW

The memorandum opinion of the referee in bankruptcy (R. 28) is unreported. The opinion of the District Court (R. 19-25) is reported in 73 F. Supp. 685. The opinion of the Circuit Court of Appeals (R. 41) is reported in 168 F. 2d 272.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on May 25, 1948. (R. 45.) The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether an estate in bankruptcy is liable for interest upon tax claims of the United States for the period from and after the date of the filing of the petition in bankruptcy until the claims are paid.

STATUTE INVOLVED

The pertinent statutory provisions are printed in Appendix A, *infra*, pp. 12-15.

STATEMENT

An involuntary petition in bankruptcy was filed against Union Fabrics, Inc., on December 20, 1939. (R. 4.) The United States and the State of New York filed tax claims, asking for interest to the date of payment of the claims.[1] By notices dated

[1] The claims of the United States were for social security taxes for the years 1936, 1937, 1938 and 1939, income taxes for 1935 and 1936, and a miscellaneous tax for 1935 (R. 20), aggregating $9,865.35 (R. 7). The New York State tax claims were for franchise taxes for 1936, 1937 and 1938 and for unemployment insurance taxes (R. 20), aggregating in all $1,660.92 (R. 7). The amount of interest at the rate of 6 per cent per annum on $11,526.27, the aggregate of the claims of both the United States and the State of New York, from December 20, 1939, to February 6, 1947, the date of the trustee's petition to reopen the proceeding, was $4,930.08. (R. 7.)

July 1 and 2, 1946, the trustee in bankruptcy filed objections to the demands for interest on these claims of the United States and of the State of New York beyond the date of the filing of the petition in bankruptcy. (R. 5.) After consolidated hearings, the referee in bankruptcy, on January 24, 1947, filed separate findings of fact and conclusions of law and on the same day filed a consolidated memorandum overruling the trustee's objections to the allowance of interest to the date of payment on the claims of both the United States and the State of New York, and entered orders to that effect. (R. 5, 26-30.) Thereafter the referee reopened the proceeding for the purpose of hearing a further objection by the trustee, based upon certain alleged equitable considerations, but sustained the objections to this evidence and made an order to that effect. (R. 5-8.) Upon a petition for review, the district judge reversed the orders allowing interest on the tax claims to the date of payment and sustaining objections to the trustee's offer of proof at the rehearing. (R. 14-15, 17-19.) He held that interest on the tax claims of both the United States and the State of New York should be treated in the same manner as interest on other claims and not allowed beyond the date of the filing of the petition. (R. 20-24.) With respect to the evidence offered to explain a long delay in the administration of the estate, he regarded such equitable considerations, if pertinent to the determination, as sufficiently shown by the records of the court to augment other reasons for the denial of such interest. (R. 24-25.)

The court below affirmed the orders of the District Court upon the authority of *Saper* v. *City of*

New York, 168 F. 2d 268,[2] decided the same day, as representing the view of the majority of the five judges, sitting in either the *Saper* case or in the instant case, who considered the issue here involved. (R. 42.) However, two of the three judges, who sat in the instant case, did not agree with the opinion of the other three judges who sat in the *Saper* case nor with the decision of the District Court, but acquiesced in the decision of the court below on this question in the *Saper* case, *supra*, since:

> Such a mode of dealing with the appeal before us will settle the law in this circuit as to the allowance of interest on tax claims unless the Supreme Court should hereafter reach a different conclusion.

Nevertheless, in the opinion below, they considered it advisable to state their personal views which were in accord with those of the First Circuit Court of Appeals in *Davis* v. *Green*, 133 F. 2d 451 (R. 42.)

SPECIFICATION OF ERRORS TO BE URGED

The Circuit Court of Appeals erred:

1. In holding that interest on the tax claims of the United States should be allowed only to the date of the filing of the petition in bankruptcy.

2. In failing to hold that interest on the tax claims of the United States should be allowed after

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[2] For convenience the opinion of the court below in the *Saper* case is printed as Appendix B, *infra*, pp. 16-25.

the date of the filing of the petition in bankruptcy and to the date of the payment of these claims.

3. In affirming the order of the District Court.

REASONS FOR GRANTING THE WRIT

1. The decisions of the court below in the instant case and in *Saper* v. *City of New York*, 168 F. 2d 268 (Appendix B, *infra*, pp. 16-25), upon the authority of which the instant case was decided, are directly in conflict with the decision of the First Circuit Court of Appeals in *Davie* v. *Green*, 133 F. 2d 451. This conflict was conceded in the court below both by the three majority judges who sat in the *Saper* case[3] (Appendix B, *infra*, p. 18) and by the two judges in the minority who wrote the opinion in the instant case[4] (R. 42-43).

In the *Saper* case, the majority of the court below reversed the decision of Judge Coxe in the District Court for the Southern District of New York, *sub nom. In re Spotlight Productions*, 75 F. Supp. 458, whose opinion supported the Government's position here; on the other hand, in the instant case, on the authority of the *Saper* case, the opinion of the District Court by Judge Bright (R. 19-25) was affirmed. Indicating the necessity for the settlement by this Court of the disputed question here involved, Judge Clark,[5] writing for the court

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[3] Judges Learned Hand, Swan and Clark.

[4] Judges Augustus N. Hand and Chase.

[5] Judge Clark was the third judge who sat in the instant case and while concurring in the result (R. 44), did not, of course, join in the opinion below, which, as already stated, expressed the contrary views of Judges Augustus N. Hand and Chase.

below in the *Saper* case, succinctly defined the division in the court below and the conflict of the majority with the decision of the First Circuit Court of Appeals, as follows (Appendix B, *infra*, pp. 17-18):

> The matter has been in dispute and must remain so until settled by the Supreme Court. As will appear, the members of this court are not in accord as to the result to be reached. The court as presently constituted is agreed that Judge Coxe's decision, D. C. S. D. N. Y., 75 F. Supp. 458, should be reversed. His decision, however, was in accord with *Davie v. Green*, 1 Cir., 133 F. 2d 451 (which had reversed a referee and a district judge), and has the support of some other district court opinions, *e.g.*, *In re Flayton*, D. C. E. D. N. Y., 42 F. Supp. 1002; and *cf. In re L. Gandolfi & Co.*, D. C. S. D. N. Y., 42 F. Supp. 706. It is contrary to the decision of Judge Bright in *Re Union Fabrics*, D. C. S. D. N. Y., 73 F. Supp. 685, the appeal from which is decided herewith, with the writer of this opinion alone of the court there sitting in agreement with Judge Bright.

2. Clearly, the question presented is of importance in the administration of the federal bankruptcy and tax laws. Indeed, in the *Saper* case the court below observed (Appendix B, *infra*, p. 17):

> The decision must affect all tax claims in bankruptcy, from those of the federal government to those of any state or subdivision thereof.

Settlement of the question by this Court is plainly in the public interest, since it is likely to be presented in almost every bankruptcy proceeding, including many hundreds now pending, and involves not only tax claims of the Federal Government, but also tax claims of every state or subdivision thereof. Bankruptcy Act of 1898, c. 541, 30 Stat. 544, Sections 57j and n and 64a, as amended (Appendix A, *infra*, pp. 12-15).

3. The decision of the court below is believed to be erroneous and the conflicting decision of the First Circuit Court of Appeals in *Davie* v. *Green*, *supra*, correct. Moreover, the decision below probably conflicts with applicable decisions of this Court. It is generally agreed that in 1924 this Court held, in *United States* v. *Childs*, 266 U. S. 304, though without separate discussion,[6] that claims in bankruptcy for taxes drew interest until paid. (First Circuit in *Davie* v. *Green*, *supra*, and the court below, both in the majority opinion in the *Saper* case (Appendix B, *infra*, p. 19) and the minority opinion in the instant case.) (R. 42-43.) In the *Saper* case, however, the majority of the court below held that Congress, by the Act of June 22, 1938, c. 575, 52 Stat. 840, commonly known as the Chandler Act, changed the prior rule with the consequence that thereafter claims for taxes, like

[6] However, as noted in the opinion below, the question was raised in this Court in the arguments of counsel as reported. (R. 42-43). Indeed, it had been expressly decided in the Government's favor by the court below, in the cited case, *sub nom. In re J. Menist & Co.*, 290 Fed. 947, 949-950 (C. C. A. 2d).

other claims, drew interest only to the date of filing of the petition in bankruptcy." (Appendix B, infra, pp. 20-22.) This change in existing law was not made by Congress expressly, but was inferred by the court below from the fact that by the 1938 amendments taxes were classified as debts within Section 64(a) and were required to be proved and filed under Section 57 in the same manner as the claims of other creditors.

The opposing construction is set forth in detail in the opinion of the First Circuit in *Davis* v. *Green*, *supra*, p. 453, and of Judge A. N. Hand in the instant case. (R. 43-44.) In brief, their position is that when Congress passed the Chandler Act, it made many fundamental changes in the law of bankruptcy, and that if it had wished to change pre-existing law to place claims for taxes on the same footing as other claims with respect to interest, it would have done so by specific enactment and in clear and unmistakable terms.[7]

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[7] Moreover, the decision below turns squarely and solely on construction of the applicable federal statutes as a matter of law, since the alleged equitable considerations referred to in the opinion of the District Court (R. 24-25) did not enter into the *ratio decidendi* of either the majority or the minority opinions.

[8] Moreover, the history of federal revenue legislation indicates that Congress intended interest on tax claims to run against estates held by fiduciaries. Revenue Act of 1924, c. 234, 43 Stat. 253, Section 276(c); Revenue Act of 1926, c. 27, 44 Stat. 9, Section 276(c); 67 Cong. Rec., Part 3, p. 3377; *In re Simon*, 11 F. Supp. 18 (D. Conn.), affirmed on other grounds, 80 F. 2d 81 (C. C. A. 2d); cf. *Saper* v. *City of New York* (Appendix B, *infra*, p. 24, fn. 2).

Further, if so well settled and fundamental an interpretation requires, as contended, alteration on the grounds of policy such as alleged injustice or hardship upon general creditors, relief is not with the courts but with the legislature. Indeed, such an express amendment to the statute was proposed to the Eightieth Congress, passed the House of Representatives on June 8, 1948 (94 Cong. Rec. (D. I.), No. 103, p. 7572), and at the time of recess on June 20 was pending in the Senate Committee on the Judiciary.[3] The Report of the House Committee on the Judiciary, which recommended the amendment, clearly indicates its understanding that the Chandler Act had not changed the rule that tax claims in bankruptcy bear interest until payment, and that a

[3] H. R. 5693, which, so far as here pertinent, provides as follows (94 Cong. Rec. (D. I.), No. 103, p. 7569):

> SEC. 11(a) Subdivision j of section 57 of such act, as amended, is amended to read as follows:
>
> "j. (1) Debts owing to the United States or to any State or any subdivision thereof as a penalty or forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained by the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interest as may have accrued on the amount of such loss up to the date of bankruptcy.
>
> "(2) Except where the estate of the bankrupt is solvent, interest accruing after the date of bankruptcy on taxes legally due and owing to the United States or to any State or any subdivision thereof shall not be allowed."

However, this bill even if passed will not dispose of the controversy involved in the instant case nor in the multitude of other pending bankruptcy proceedings. Thus, the bill proposed (p. 7572):

specific amendment would be necessary to change that rule. H. Rep. No. 2083, 80th Cong., 2d Sess., p. 5.[9]

SEC. 31. Effect of this Amendatory Act: (a) Nothing herein contained shall have the effect to release or extinguish any penalty, forfeiture, or liability incurred under any act or acts of which this act is amendatory.

(b) The provisions of this amendatory act shall govern proceedings so far as practicable and applicable in cases pending when it takes effect; but proceedings in cases then pending to which the provisions of this amendatory act are not applicable shall be disposed of conformably to the provisions of said act approved July 1, 1898, and the acts amendatory thereof and supplementary thereto.

SEC. 32. This amendatory act shall take effect and be in force on and after three months from the date of its approval.

[9] H. Rep. No. 2083, 80th Cong., 2d Sess., p. 5:

The addition of clause (2) in the bill is intended to overrule an obsolete rule as to interest on delinquent tax debts. Interest on general unsecured debts, on unsecured Government debts other than taxes, and on debts entitled to priority under section 64a, is suspended at the date of bankruptcy so that, except in the rare case of a solvent estate, interest is allowable only to such date. (Sec. 63a; *Adams* v. *Napa Cantina Wineries* (C. C. A. 9th Cir.), 36 Am. B. R. (N. S.) 8; *In re Gandolfi & Co., Inc.* (S. D., N. Y.), 51 Am. B. R. (N. S.) 521 (governmental debts and other debts entitled to priority); 3 *Collier on Bankruptcy*, 14th Ed., 1835 *et seq.*; 2 *Remington on Bankruptcy*, 4th Ed., secs. 771, 795). However, interest on delinquent tax debts is allowable to the date of payment (*In re Kallak* (D. C., N. D., 1906), 17 Am. B. R. 414; *In re Ashland Emery and Corundum Co.* (D. C., Mass. 1916), 36 Am. B. R. 194; *In re Clark Realty Co.* (C. C. A., 7th Cir., 1918), 42 Am. B. R. 403; *sub silentio, United States* v. *Childs*, 266 U. S. 304, 307

CONCLUSION

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted.

PHILIP B. PERLMAN,
Solicitor General.

August, 1948.

(1924), 5 Am. B. R. (N. S.) 5). *Although, under the Chandler Act, a tax debt is required to be proved (sec. 57n) and its order of priority ranks below all administration costs and expenses, wages and costs and expenses of creditors successfully opposing a settlement or discharge, or procuring a conviction for an offense (sec. 64a (1), (2), (3)), thereby rendering obsolete the reasoning in the Kallak case, nevertheless its rule has not been changed, and therefore requires this statutory modification.* * * And on overruling the *Kallak* case see *In re Union Fabrics, Inc.* (S. D., N. Y., 1947), 73 F. Supp. 685, appeal pending. (Italics added.)

APPENDIX A

Bankruptcy Act of 1898, c. 541, 30 Stat. 544:

SEC. 57. PROOF AND ALLOWANCE OF CLAIMS.

* * *

j. [as amended by the Act of June 22, 1938, c. 575, 52 Stat. 840, Sec. 1]: Debts owing to the United States or any State or subdivision thereof as a penalty or forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained by the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interest as may have accrued thereon according to law.

* * *

n. [as amended by the Act of May 27, 1926, c. 406, 44 Stat. 662, Sec. 13; Act of June 22, 1938, c. 575, 52 Stat. 840, Sec. 1] Except as otherwise provided in this Act, all claims provable under this Act, including all claims of the United States and of any State or subdivision thereof, shall be proved and filed in the manner provided in this section. Claims which are not filed within six months after the first date set for the first meeting of creditors shall not be allowed: *Provided, however*, That the court may, upon application before the expiration of such period and for cause shown, grant a reasonable fixed extension of time for the filing of claims by the United States or any State or subdivision thereof: * * *.

(11 U. S. C. 1946 ed., Sec. 93.)

SEC. 64. DEBTS WHICH HAVE PRIORITY. [as amended by the Act of May 27, 1926, c. 406, 44 Stat. 662, Sec. 15; Act of June 22, 1938, c. 575, 52 Stat. 840, Sec. 1; Act of June 28, 1946, c. 512, 60 Stat. 323, Sec. 12]

a. The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be (1) the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition; the fees for the referees' salary fund and for the referees' expense fund; the filing fees paid by creditors in involuntary cases; where property of the bankrupt, transferred or concealed by him either before or after the filing of the petition, shall have been recovered for the benefit of the estate of the bankrupt by the efforts and at the cost and expense of one or more creditors, the reasonable costs and expenses of such recovery; the costs and expenses of administration, including the trustee's expenses in opposing the bankrupt's discharge, the fees and mileage payable to witnesses as now or hereafter provided by the laws of the United States, and one reasonable attorney's fee, for the professional services actually rendered, irrespective of the number of attorneys employed, to the petitioning creditors in involuntary cases and to the bankrupt in voluntary and involuntary cases, as the court may allow; (2) wages, not to exceed $600 to each claimant, which have been earned within three months

before the date of the commencement of the proceeding, due to workmen, servants, clerks, or traveling or city salesmen on salary or commission basis, whole or part time, whether or not selling exclusively for the bankrupt; (3) where the confirmation of an arrangement or wage-earner plan or the bankrupt's discharge has been refused, revoked, or set aside upon the objection and through the efforts and at the cost and expense of one or more creditors, or, where through the efforts and at the cost and expense of one or more creditors, evidence shall have been adduced resulting in the conviction of any person of an offense under this Act, the reasonable costs and expenses of such creditors in obtaining such refusal, revocation, or setting aside, or in adducing such evidence; (4) taxes legally due and owing by the bankrupt to the United States or any State or any subdivision thereof: *Provided,* That no order shall be made for the payment of a tax assessed against any property of the bankrupt in excess of the value of the interest of the bankrupt estate therein as determined by the court: *And provided further,* That, in case any question arises as to the amount or legality of any taxes, such question shall be heard and determined by the court; and (5) debts owing to any person, including the United States, who by the laws of the United States in [sic] entitled to priority, and rent owing to a landlord who is entitled to priority by applicable State law: *Provided, however,* That such priority for rent to a landlord shall be restricted to the rent which

is legally due and owing for the actual use and occupancy of the premises affected, and which accrued within three months before the date of bankruptcy.

(11 U. S. C. 1946 ed., Sec. 104.)

APPENDIX B

Opinion of the court below in *Leonard H. Saper, as Trustee in Bankruptcy of Spotlight Productions, Inc.* v. *The City of New York*, decided May 25, 1948.

Before: L. Hand, Swan and Clark, Circuit Judges.

Appeal from the District Court of the United States for the Southern District of New York.

Petition by Lewis H. Saper, as trustee of Spotlight Productions, Inc., bankrupt, for review of an order of a referee in bankruptcy refusing to expunge the claim of the City of New York against the bankrupt for sales and business taxes and ordering the payment of the claim, together with interest at the rate of one per cent per month until the date of payment. From an order affirming the order of the referee, D.C.S.D.N.Y., 75 F. Supp. 158, the petitioner appeals. Order affirmed as to the principal of the taxes, but reversed as to the interest.

[Names of counsel]

CLARK, *Circuit Judge*:

(1) The first point on this appeal concerns the validity of a claim against an estate in bankruptcy for certain sales and business taxes levied by the City of New York against the bankrupt. The trustee concedes the validity of such taxes as were levied upon the bankrupt's sales of machinery manufactured by it, but contests the tax levied on its

purchases of materials. But, as stated in the opinion below, D.C.S.D.N.Y., 75 F. Supp. 458, this is directly contrary to the law and the rulings under it. It is quite settled that both seller and purchaser may be held liable for the city sales tax, though in fact it is primarily imposed upon the purchaser, who must pay it to the City Treasurer if he has failed to pay it to his vendor. § N41-2.0, subds. e, f, of the Administrative Code, New York City. *Kesbeck, Inc. v. McGoldrick*, 278 N. Y. 293, 297, 16 N. E. 2d 288, 119 A. L. R. 536, reargument denied 278 N. Y. 716, 17 N. E. 2d 136; *Fifth Ave Bldg. Co. v. Joseph*, 272 App. Div. 449, 71 N. Y. S. 2d 566; *City of New York v. Feiring*, 313 U. S. 283. The liability of the estate is clear.

(2) The other point, however, the liability of the estate for interest upon these tax claims after bankruptcy and until they are paid, is interesting, important, and difficult. Both the referee and the district court have allowed interest, at the high rate provided by the local code of one per cent per month, so that the accumulating interest is fast approaching the face of the claim.[1] The decision must affect all tax claims in bankruptcy, from those of the federal government to those of any state or subdivision thereof. The matter has been in dis-

[1] The tax period involved as Nov. 1, 1940, to May 31, 1942; the petition in bankruptcy was filed Jan. 5, 1944, and the City's claim originally on May 19, 1944; the referee's order of allowance was made on July 18, 1947. In that order he allowed a sales tax of $495.61, with interest to date of $341.97, and a business tax of $19.72, with interest of $13.13, and made express provision for additional interest at the rate of 1% per month until payment.

pute and must remain so until settled by the Supreme Court. As will appear, the members of this court are not in accord as to the result to be reached. The court as presently constituted is agreed that Judge Coxe's decision, D.C.S.D.N.Y., 75 F. Supp. 458, should be reversed. His decision, however, was in accord with *Davie* v. *Green*, 1 Cir., 133 F. 2d 451 (which had reversed a referee and a district judge), and has the support of some other district court opinions, *e.g.*, *In re Flayton*, D.C.E.D.N.Y., 42 F. Supp. 1002; and *cf. In re L. Gandolfi & Co.*, D.C.S.D.N.Y., 42 F. Supp. 706. It is contrary to the decision of Judge Bright in *Re Union Fabrics*, D.C.S.D.N.Y., 73 F. Supp. 685, the appeal from which is decided herewith,[2] with the writer of this opinion alone of the court there sitting in agreement with Judge Bright. Our decision herein was perhaps somewhat foreshadowed by the remarks of Judge L. Hand in *Hammer* v. *Tuffy*, 2 Cir., 145 F. 2d 447, 449, leaving the question open, and by those of Judge Swan in *United States* v. *Roth*, 2 Cir., 164 F. 2d 575, pointing out that under the recent congressional enactments tax claims were treated substantially as debts of the bankrupt. It is in accord with the views of text writers, notably Messrs. Moore and Oglebay, 3 Collier on Bankruptcy, 14th Ed. 1941, par. 63.16, reiterated in 1946 Cum. Supp. 131, 132, also Mr. Oglebay in 17 J.N.A. Ref. Bankr. 127, 129, 130, 21 *id.* 106, 107, 22 *id.* 41, and the commentator in 61 Harv. L. Rev. 354.

For reasons both of administrative convenience and of fundamental justice and equity it has been

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[2] *Carter* v. *United States et al.*, 2 Cir. 168 F. 2d 274.

steadily held, following the English practice, that interest does not accrue upon claims during the period of bankruptcy administration. *Sexton* v. *Dreyfus*, 219 U. S. 339, 344; *Vanston Bondholders Protective Committee* v. *Green*, 329 U. S. 156, 163, 165; 3 Collier, *loc. cit. supra*.[3] A single exception, that for tax claims, was developed judicially. It appears to have begun with *In re Kallak*, D.C.N.D., 147 F. 276, though the contemporaneous case of *In re William F. Fisher & Co.*, D.C.N.J., 148 F. 907, held to the contrary. But the *Kallak* case set the pattern and was followed by other cases, including *In re J. Menist & Co.*, 2 Cir., 290 F. 947, which, however, allowed interest only at the legal rate. When the Supreme Court reversed this holding to allow interest at the statutory rate, though without separate discussion of our particular problem, *United States* v. *Childs*, 1924, 266 U. S. 304, the matter was considered settled. The reason for the rule was that the original Bankruptcy Act treated tax claims quite differently from other debts; instead of requiring their presentation in due course, it provided that "the court shall order the trustee to pay all taxes legally due and owing by the bankrupt to the United States, State, county, district, or municipality, in advance of the payment of dividends to creditors." § 64a, 11 U. S. C. A. § 104 (a) (before amendment). Hence the trustee was, in effect, compelled to search them out. So taxes were

[3] If, however, a sufficiency of assets develops, the claims will bear interest; and though the usual rule applies also to secured claims, yet where the security itself yields interest or dividends, those are applicable to interest on the claims. 3 Collier, *loc. cit. supra*.

in altogether a separate class; they were to be paid before any administration of the estate, properly speaking, and thus had an absolute priority over the bankrupt's debts. In view of this peculiarly favored position, the like result as to interest was certainly not unnatural, even if not compelled.

In 1926, however, § 64a was amended, by adding the words "in the order of priority as set forth in paragraph (b)"; and of the seven priorities provided in (b), taxes came sixth or next to the last. Even that change might have been considered sufficient to reduce taxes to the status of debts in view of the obvious doubt as to the payment of interest upon a sixth claim in a series where the earlier five admittedly carried none. Moreover, § 64b spoke of the debts "to have priority" in advance of the payment of dividends to creditors, "and to be paid in full out of bankrupt estates," in the order then stated; it was at least odd to think that a wage claim up to $600 was "paid in full" when paid without interest, whereas a tax claim of later priority was not so paid until interest of 12 per cent or more was included.[4] But the issue did not come before the Supreme Court; and apparently the lower federal courts continued their former practice. *Cf. Horn* v. *Boone County, Neb.*, 8 Cir., 44 F. 2d 920; *In re Semon*, D. C. Conn., 11 F. Supp. 18, modified on other grounds, 2 Cir., 80 F. 2d 81.

At any rate the process of assimilation of tax claims to other debts appears, to us at least, to have been completed by the Chandler amendments of

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[4] For the meaning of "paid in full" as limited to the principal, see *Hammer* v. *Tuffy*, *supra*, 145 F. 2d at page 449.

1938. Indeed we thus described the changes in *United States ex. Roth, supra*, 164 F. 2d at pages 577, 578: "By the 1938 amendments, however, taxes were classified as 'debts' within section 64, sub. a, 11 U.S.C.A. § 104, sub. a, and section 57, sub. n, 11 U.S.C.A. § 93, sub. n, was broadened to include 'all claims of the United States' and require them to 'be proved and filed in the manner provided in this section.'[3] Subdivision a of section 57, 11 U.S.C.A. § 93, sub. a, provides that a proof of claim shall state among other matters 'that the claim is justly owing from the bankrupt to the creditor'; * * * Thus it is apparent that the Act, as it now stands, treats the tax claim as a debt and the United States as a creditor which, like other creditors, must make proof of claim on a form" prescribed by the Supreme Court. This, then, took from tax claims their former favored position where no proof or other governmental action was necessary for their enforcement. Thenceforth they must be proved, or otherwise be barred, just like other debts of the bankrupt.

We see no reason to suppose that this did not place tax claims in the same situation as other debts

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[3] In addition, by these amendments the priority subdivision formerly § 64b became § 64a, and the classes of priorities were changed to five instead of seven, the status of tax claims being still next to the last or (4) instead of (6). This was no advancement in position, since former classes (1), (2), and (3) were combined with (1). In 1946, there was added to (1) "the fees for the referees' salary fund and for the referees' expense fund." [This note is not a part of the quotation.]

with respect to interest also.[6] The chief ground taken in *Davis v. Green*, *supra*, and the other cases which argue for the priority of interest, as well as principal, though conceding its inequity, is that Congress by failing to exclude it has re-enacted the old rule. It is dubious at best to rely upon such congressional adoption where "a close scrutiny of the various reports and hearings on the Chandler Act or its predecessor bills reveals nothing to indicate that the problem was ever under consideration." 3 Collier on Bankruptcy, 1946 Cum. Supp., at n. 28a of par. 63.16; 61 Harv. L. Rev. 354. But it is submitted with deference that the pinch is on the other foot. When Congress provided that taxes must be proven like other debts and put them in, and well down in, a hierarchy of other claims, none of which bore interest, we think that like treatment was intended unless some specific exception was stated. This seems all the more likely when we recall the dubious and uncertain history of the original judicial exception.

This conclusion seems to us fortified by arguments of practicality and convenience—if not of equity, as stressed by Judge Bright—which would naturally appeal to legislators or draftsmen, if a

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[6] By making a tax claim a debt of the bankrupt it is brought within the terms of § 63a, 11 U. S. C. A. § 103 (a), defining provable debts, of which subd. (1) allows interest only up to the filing of the petition, and subd. (5) includes provable debts reduced to judgment after filing, but less costs incurred and interest after the filing. Hence under subd. (5), when a tax claim is reduced to judgment after the filing, interest must be deducted. This points up the anomaly of another rule for tax claims not reduced to judgment.

careful exploration of the subject is to be attributed to them. Of course, the allowance of accruing interest to these various state and governmental units "would necessitate constant rescheduling and recomputation of dividends available." 61 Harv. L. Rev. 354, 355. And the net result will be to promote tax claims beyond what seems the clear intent of the statute.[7] Moreover, with the very heavy interest rates now collected by states and municipalities and upheld in *Meilink* v. *Unemployment Reserves Commission of State of California*, 314 U. S. 564, it is apparent that any bankrupt estate whose settlement is delayed for any period of time is likely to be eaten up by the accruing interest on the various taxes now levied against business enterprises. As Referee Hunt points out, 17 J. N. A. Ref. Bankr. 121, 122, no trustee can afford to resist any tax claims, even with proper defenses. With interest accruing thus rapidly, he must settle at once and stop the increase in amount. True, it is suggested that this will be a boon to failing debtors who otherwise might be forced to the wall by rapacious tax collectors driven to precipitous action because the claims do not bear interest. But this is based upon an assumption both of alertness upon

[7] Assume a bankrupt to owe $1,000 to an employee for wages, $1,000 each to three taxing authorities, and $1,000 for rent given priority under state law. Under § 64a, which gives priority to the amount of $600 for wages and allows the others in order, these would be all paid in full if the assets were $5,000 and there were no other general claims beyond the $400 balance on the wage claim. But with interest allowed on the tax claims at 12% (or, perhaps more) per annum during the bankruptcy, possible payments on the later claims would diminish in size as rapidly as Alice in Wonderland.

the part of taxing officials and of the importance of this lone item in the tax structure of municipalities and the state and federal governments which seems to us to have little connection with reality.

Two further arguments of claimants must be noted. One is as to § 57j, an old provision of the law stating that debts owing the United States or any State or subdivision thereof as a penalty or forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained "and such interest as may have accrued thereon according to law." Whether this has any meaning beyond the penalty or forfeiture cases we do not need to consider, for it seems clearly to be operable only *after* the question as to what, if any, interest is legal has been decided.[8] The other is that, since tax claims, if unpaid, are not discharged in bankruptcy, then the unpaid interest on tax claims will survive against the bankrupt even after payment of the tax claims themselves. No cases appear yet to have held that interest thus survives beyond the principal claim which gives it birth. But assuming *arguendo* that interest is not discharged upon payment of the tax claim, we do not see how that fact can be decisive on the present issue. When the Chandler Act was

[8] In the companion case, the United States devotes much attention to various of the federal revenue laws and congressional debates as to changes in them with respect to interest against estates held by fiduciaries. But these do not offer any clear-cut solutions in themselves and are hardly available to change the stated priorities of a bankruptcy act. Obviously the intent of the latter is to treat federal, state and municipal tax claims alike; it would be quite improper to accord the former alone some advantage based upon some newly discovered other federal law or regulation.

under consideration, the House bill made taxes dischargeable, while the Senate amendment retained existing law. Sen. Rep. No. 1916, 75th Cong., 3d Sess., 4, stated that the committee felt "that if Federal taxes were made dischargeable, it would open the door to evasion. The Treasury Department recommended against the House amendment." Thus this was done to protect the revenue, and consideration for, or against, the bankrupt was not an issue. The fact that the bankrupt may not have received an immunity he might desire is not ground for upsetting the statutory scheme of distribution of the estate in the hands of the trustee. The point is academic here, as it will often be—since the bankrupt is a corporation whose existence will be brought to an end by the bankruptcy.

Accordingly the order on appeal will be affirmed to the extent that it refuses to expunge the tax claims, but will be reversed so far as it allows interest after the filing of the petition on January 5, 1944.

Order affirmed in part and reversed in part.

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In the Supreme Court of the United States

OCTOBER TERM, 1948

No. 201

UNITED STATES OF AMERICA, PETITIONER

v.

LEONARD H. CARTER, TRUSTEE OF UNION FABRICS, INC., BANKRUPT

ON WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES

OPINIONS BELOW

The memorandum opinion of the referee in bankruptcy (R. 19–20) is unreported. The opinion of the District Court (R. 13–17) is reported in 73 F. Supp. 685. The opinion of the Court of Appeals (R. 28–31) is reported in 168 F. 2d 272.

JURISDICTION

The judgment of the Court of Appeals was entered on May 25, 1948. (R. 32.) The petition for a writ of certiorari was filed on August 6,

1948, and was granted on October 11, 1948. (R. 33.) The jurisdiction of this Court is invoked under the provisions of 28 U. S. C. 1254.

QUESTION PRESENTED

Whether an estate in bankruptcy is liable for interest upon tax claims of the United States for the period from and after the date of the filing of the petition in bankruptcy until the claims are paid.

STATUTE INVOLVED

The pertinent provisions of the Bankruptcy Act are printed in Appendix A, *infra*, pp. 37–40.

STATEMENT

An involuntary petition in bankruptcy was filed against Union Fabrics, Inc., on December 20, 1939. (R. 3.) The United States and the State of New York filed tax claims, asking for interest to the date of payment of the claims. (R. 3–4.) The tax claims of the United States were for social security taxes for the years 1936, 1937, 1938 and 1939, income taxes for 1935 and 1936, and a miscellaneous tax for 1935 (capital stock), aggregating $9,865.35. (R. 3, 5, 13.) The New York State tax claims were for franchise taxes for 1936, 1937 and 1938 and for unemployment insurance taxes (R. 3, 13), aggregating in all $1,660.92 (R. 5). Thus, the total of the principal of the tax claims of the United States and the State of New York together amounted to $11,526.27.

(R. 5.) The interest claimed by the United States on its tax claims to the date of the filing of the petition in bankruptcy aggregated at least $1,026.67, and the interest claimed by the State of New York on its tax claims to the date of the filing of the petition in bankruptcy, aggregated $206.92. (R. 6.) The amount of interest at the rate of 6 percent per annum on $11,526.27, the aggregate of the claims of both the United States and the State of New York, from December 20, 1939, the date of the filing of the petition in bankruptcy, to February 6, 1947, the date of the trustee's petition to reopen the proceeding, referred to below, was $4,930.08 (R. 5.)

By notices dated July 1 and 2, 1946, the trustee in bankruptcy filed objections to the demands of the United States and of the State of New York for interest on these claims beyond the date of the filing of the petition in bankruptcy. (R. 3.) After consolidated hearings, the referee in bankruptcy, on January 24, 1947, filed separate findings of fact and conclusions of law and on the same date filed a consolidated memorandum overruling the trustee's objections to the allowance of interest to the date of payment on the claims of both the United States and the State of New York, and entered orders to that effect. (R. 4, 18–21.) Thereafter, the referee reopened the proceeding for the purpose of hearing a further objection by the trustee, based upon alleged equi-

table considerations, but sustained the objections to this evidence and made an order to that effect. (R. 4–6.)

Upon a petition for review, the district judge reversed the orders allowing interest on the tax claims to the date of payment and sustaining objections to the trustee's offer of proof at the rehearing. (R. 9–12.) He held that interest on the tax claims of both the United States and the State of New York should be treated in the same manner as interest on other claims and not allowed beyond the date of the filing of the petition. (R. 13–16.) With respect to the evidence offered to explain delay in the administration of the estate, he regarded such equitable considerations, if pertinent to the determination, as sufficiently shown by the records of the court to augment other reasons for the denial of the disputed interest. (R. 16–17, 28–29.)

The court below affirmed the orders of the District Court upon authority of its decision in *Saper* v. *City of New York,* 168 F. 2d 268,[1] decided the same day, as representing the view of the majority of the five judges, sitting in either the *Saper* case or in the instant case, who considered the issue here involved. Two of the three judges, who sat in the instant case, stated their personal views in the opinion below, which accord with

[1] For convenience, the opinion of the court below in the *Saper* case was printed as Appendix B, of the Government's petition for a writ of certiorari, pp. 16–25.

those of the Court of Appeals for the First Circuit in *Davie* v. *Green*, 133 F. 2d 451 (C. C. A. 1, 1943). They did not agree with the opinion of the other three judges of the court below who sat in the *Saper* case nor with the decision of the District Court here. However, they acquiesced in the decision of the court below in the *Saper* case, *supra*, since (R. 29):

> Such a mode of dealing with the appeal before us will settle the law in this circuit as to the allowance of interest on tax claims unless the Supreme Court should hereafter reach a different conclusion.

Review of the *Saper* case is pending in this Court, No. 168, this Term, and is to be heard immediately preceding the instant case. Appeal by the State of New York in the instant case is likewise pending, No. 200, this Term.

SPECIFICATION OF ERRORS TO BE URGED

The Court of Appeals erred:

1. In holding that interest on the tax claims of the United States should be allowed only to the date of filing of the petition in bankruptcy.

2. In failing to hold that interest on the tax claims of the United States should be allowed after the date of the filing of the petition in bankruptcy and to the date of the payment of these claims.

3. In affirming the order of the District Court.

SUMMARY OF ARGUMENT

It is undisputed that tax claims bore interest after bankruptcy prior to the 1938 amendments (Chandler Act) to the Bankruptcy Law. Section 57j of the Bankruptcy Act, which has remained substantially unchanged since 1898, directs allowance of such interest and was applied by this Court in *United States* v. *Childs*, 266 U. S. 304.

All of the Federal tax statutes here involved provide for 6 percent interest on unpaid taxes and that such interest shall constitute a part of the taxes. Moreover, beginning in 1924, Congress has specifically prescribed that interest shall accrue on tax claims against fiduciary estates, including the estates of insolvent persons. Thus, the Federal tax statutes here involved, construed *in pari materia* with Section 57j, are even more compelling to the result of allowing interest than were the taxing statutes considered in the *Childs* case, and evidence Congressional approval of the rule.

Although the Chandler Act in 1938 made sweeping amendments to the Bankruptcy Act, Section 57j was reenacted without material change. However, the court below concluded that changes in the status of tax claims resulting from amendments to Sections 57n and 64 evidenced a Congressional purpose, also to abolish the rule allowing interest on such claims after bankruptcy. We

believe that no such inference can properly be drawn from these amendments. In 1926, Section 64 was amended to subordinate tax claims to three-month wage claims, in addition to administration expenses which had always had the highest priority. Notwithstanding this reduced priority for taxes, the bankruptcy courts continued regularly to allow interest on tax claims after the commencement of bankruptcy. The 1938 amendments were purely procedural in so far as they affected tax claims; the sole purpose and result were to require governmental claims to be proved and filed in the same manner as other claims, instead of requiring the trustee to seek out and pay the tax claims. In fact, this change in procedure added nothing new—it merely codified the judicially devised bar order procedure under which tax authorities could be required to file their tax claims within a prescribed period or be barred from participation in the estate. We believe, therefore, that in so far as the 1938 amendments related to tax claims they were too unimportant to offset the strong inference that the reenactment of Section 57j was intended to continue in effect the settled rule allowing interest on tax claims after bankruptcy. The rule is too important, affecting as it does not only the Federal but also the state and local governments, to infer from such sparse materials a Congressional intent to change it. To the extent that changing the rule

would provide a new basis for tax exemption or tax forgiveness, it is in conflict with the established rule of construction that exemptions from taxation must be conferred by Congress specifically, and may not be implied.

Any doubt as to the present rule is removed by the fact that during the last session of Congress, the House of Representatives passed a bill which, *inter alia*, would have specifically amended Section 57j to forbid accrual of interest on taxes after the date of bankruptcy. The report of the House Judicial Committee clearly evidences the understanding of that body that existing law allows interest on tax claims after bankruptcy and that specific legislation is required to change the rule. A similar understanding on the part of the Judicial Conference is reflected in its similar recommendation for legislative change. Whatever equitable considerations may be involved in the question were not relied upon by either the First or Second Circuit Courts of Appeals, and should be addressed to Congress in any event.

ARGUMENT

I

THE RULE THAT INTEREST MAY ACCRUE ON TAX CLAIMS AFTER BANKRUPTCY AND UNTIL SUCH CLAIMS ARE PAID, DERIVES FROM SECTION 57j OF THE BANKRUPTCY ACT WHICH WAS REENACTED WITHOUT CHANGE IN 1938, AND FROM THE APPLICABLE TAXING STATUTES

A. SECTION 57j OF THE BANKRUPTCY ACT DIRECTS ALLOWANCE OF INTEREST ON TAX CLAIMS DURING BANKRUPTCY

Although, as noted above, there is conflict between the Courts of Appeals for the First and Second Circuits as to whether interest presently runs on tax claims after the filing of a petition in bankruptcy, it is undisputed that tax claims bore interest during bankruptcy prior to the 1938 amendments (Chandler Act) to the Bankruptcy Act. *Davis* v. *Green, supra,* at p. 453; the opinion below, R. 29–30.

The allowance of interest during bankruptcy on tax claims has been based upon Section 57j which, in substantially its present form, has been in the Bankruptcy Act since 1898.[2] That subsection presently provides as follows:

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[2] The following shows the changes in Section 57j of the Bankruptcy Act of 1898 by the Chandler Act. The matter in brackets represents the portion of the old section that has been deleted. The matter in italics represents additions made by the Chandler Act. The remainder is unchanged.

"SEC. 57. PROOF AND ALLOWANCE OF CLAIMS.

* * * * * *

"j. Debts owing to the United States *or any State or sub-*

> j. Debts owing to the United States or any State or subdivision thereof as a penalty or forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained by the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interest as may have accrued thereon according to law.

The leading case is *In re J. Menist & Co.*, 290 Fed. 947, 949–950 (C. C. A. 2, 1923) in which the court below held that under the provisions of Section 57j, tax claims bore interest during bankruptcy and until payment, and was affirmed by this Court on that point without discussion, *sub nom. United States* v. *Childs*, 266 U. S. 304. However, the question was specifically briefed and argued in this Court. *United States* v. *Childs*, *supra*, pp. 305–306.[3] In its opinion, the court below had expressly decided the issue and held that under the Bankruptcy Act (*In re J. Menist & Co.*, *supra*, p. 950)—

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division thereof [a State, a county, a district, or a municipality] as a penalty or forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained by the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interest as may have accrued thereon according to law."

[3] Thus, Point I of the trustee's brief (pp. 1–5) in *United States* v. *Childs*, *supra*, was that "The Government is not entitled to interest upon its claim for taxes after the filing of the petition in bankruptcy."

> section 57j requires penalties due to the United States, or a state, etc., to be allowed to the extent of the pecuniary loss suffered. The loss continues as much after petition filed as before.

Declaring that (p. 949)—

> in tax matters * * * one party commands and the other must obey, and again subject to constitutional limitations the commanding party may impose any terms of payment that it pleases, and it makes no difference whether the price of delayed obedience is called interest, or penalty, or fine, or additional tax; every increase over the amount that satisfies the tax, if paid the moment it is levied, is merely an additional exercise of the power of the taxing authority.[4]

it then went on to consider whether or not the exaction of 1 percent a month by the taxing statute there involved as the price of delay constituted more than the amount of pecuniary loss sustained by the delayed payment; and ruled against the Government that the excess beyond 6 percent per annum was not compensatory and therefore not allowable. On the Government's appeal, this Court held that the entire 1 percent per month interest represented only the price of delay and was therefore allowable. Thus, this Court affirmed the Court of Appeals in-

[4] See discussion at pp. 14–15, *infra*, and the taxing act provisions quoted in Appendix B, to the effect that the interest is added *as part of the tax*.

the ruling that interest during bankruptcy was authorized by Section 57j as compensation allowed to the extent of a pecuniary loss suffered. This Court's approval of this construction of Section 57j is also implicit in the following statement in the *Childs* opinion, *supra,* pp. 308, 309–310:

> The Circuit Court of Appeals adjudged the tax in the present case a debt and assigned against it interest at 6%; the court considered that that interest was compensation for the delinquency, anything in excess becoming penalty and within the prohibition of § 57–j. * * *
>
> * * * * *
>
> * * * Interest is put upon it and so denominated, distinguished from the 5% as penalty, clearly intended to compensate the delay in payment of the tax—the detriment of its nonpayment, to be continued during the time of its nonpayment—compensation, not punishment.

For other cases recognizing and applying the rule that interest accrues on tax claims during bankruptcy, see *Dayton* v. *Pueblo County,* 241 U. S. 588; *New York* v. *Jersawit,* 263 U. S. 493; *Meilink* v. *Unemployment Comm'n,* 314 U. S. 564; *In re Kallak,* 147 Fed. 276 (D. N. D. 1906); *In re Ashland Emery & Corundum Co.,* 229 Fed. 829 (D. Mass. 1916); *In re Clark Realty Co.,* 253 Fed. 938 (C. C. A. 7, 1918); *In re A. E. Fountain, Inc.,* 295 Fed. 873 (S. D. N. Y. 1924); *Horn* v. *Boone County, Neb.,* 44 F. 2d 920 (C. C. A. 8,

1930); *In re L. Gandolfi & Co.*, 42 F. Supp. 706 (S. D. N. Y. 1940); *In re Semon*, 11 F. Supp. 18, 20–21 (D. Conn., 1935), modified, 80 F. 2d 81 (C. C. A. 2, 1935). The summary statement to the contrary, found in the early case of *In re William F. Fisher & Co.*, 148 Fed. 907, 913 (D. N. J. 1906), was made in passing without discussion, and has not been followed.

It should be noted that the Court of Appeals for the First Circuit, in *Davie* v. *Green, supra*, at page 453, found further support for the rule of the *Childs* case in the last words of Section 57j. Thus, it noted that in enacting the Chandler Act amendments, the Congress (p. 453)—

> left untouched the last words of that section which provide for the payment of debts due the United States or any State or subdivision thereof with "such interest as may have accrued thereon according to law" which words the courts had repeatedly construed, rightly or wrongly, to mean interest to the date of payment.

In brief, the federal courts, except the court below in this case and in the *Saper* case, have repeatedly found in Section 57j the command that interest shall be allowed on tax claims during bankruptcy and until the date of payment of such claims. As the *Childs* case illustrates, the only difficulty which Section 57j has given the courts during this period has been distinguishing "in-

terest" from "penalties", which under that section cannot be allowed.

In the earlier case of *In re Kallak,* 147 Fed. 276 (D. N. D., 1906), the allowance of interest during bankruptcy on tax claims seems to have been predicated upon the highly preferred status of tax claims under Section 64 prior to its amendment in 1926.[5] And there is an intimation to the same effect in *In re J. Menist & Co., supra.* To the contrary, however, even after the amendment of Section 64 to subordinate tax claims to wage claims, the courts continued to interpret Section 57j as permitting interest to accrue on tax claims during bankruptcy. *Horn* v. *Boone County,* 44 F. 2d 920 (C. C. A. 8, 1930); *In re Semon,* 11 F. Supp. 18 (D. Conn., 1935), modified, 80 F. 2d 81 (C. C. A. 2, 1935). Finally, as noted hereafter (pp. 34–36), the history of H. R. 5693 during the second session of the 80th Congress demonstrates clearly that when Congress considered changing the rule, it would have done so by specifically amending Section 57j.

B. THE APPLICABLE FEDERAL TAXING STATUTES CONFIRM THE CONSTRUCTION OF SECTION 57j AS ALLOWING INTEREST ON TAX CLAIMS DURING BANKRUPTCY

The federal taxes involved in the instant case were levied under statutes which in each case prescribe interest at 6% for delay in payment and provide that such interest shall be collected *as*

[5] See discussion *infra*, at pp. 25–26.

part of the tax.[6] Under the decisions prior to the instant case, these provisions certainly would have been construed with Section 57j to require the allowance of interest on these taxes after bankruptcy and until the date of payment.

In addition, however, beginning with the Revenue Act of 1924, Congress made doubly clear its purpose that tax claims bear interest during bankruptcy, by making express provision as to interest on tax claims against fiduciary estates. This development may be traced back to Section 276 of the Revenue Act of 1924, c. 234, 43 Stat. 253, which was the predecessor of Section 294 (a) (1) and (c), of the Revenue Acts of 1934 and 1936, quoted in Appendix B, *infra*, pp. 42–43, imposing additions to the income tax in case of nonpayment. Section 276 (a) (1) of the 1924 Act was substantially identical with Section 294 (a) (1) of the 1934 Act quoted in Appendix B, *infra*, at p. 42. Section 276 (c) was new in the 1924 Act and read as follows:

> (c) In the case of estates of incompetent, deceased, or insolvent persons, there shall be collected interest at the rate of 6 per centum per annum in lieu of the interest provided in subdivisions (a) and (b) of this section.

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[6] These statutory provisions are set forth in Appendix B. Moreover, even without these specific statutory provisions, interest would be payable upon these tax claims until paid. *Billings* v. *United States*, 232 U. S. 261, 284–288.

In recommending this subsection, the Committee on Ways and Means explained its purpose as follows (H. Rep. No. 179, 68th Cong., 1st sess., p. 26 (1939–1 Cum. Bull. (Part 2) 241, 259)):

> Section 276 (c). Although estates of "insane, deceased, or insolvent persons" are excepted from the additions to the tax provided in section 250 (e) of the existing law [Revenue Act of 1921] no interest upon the amounts due and unpaid by such estates is there provided. This subdivision provides for interest at the rate of 5 percent.

In proposing interest at 6 percent, the Senate Committee on Finance made the following statement (S. Rep. No. 398, 68th Cong., 1st Sess., p. 32 (1939–1 Cum. Bull. (Part 2) 266, 288)):

> Section 276 (c). Although estates of "insane, deceased, or insolvent persons" are excepted from the additions to the tax provided in section 250 (e) of the existing law no interest upon the amounts due and unpaid by such estates is there provided. This subdivision provides for interest at the rate of 6 percent. * * *

The Revenue Act of 1926 changed Section 276 (c) to read substantially the same as the controlling Sections 294 (c) of the Revenue Acts of 1934 and 1936, Appendix B, *infra*, pp. 42–43. Instead of the first clause of Section 276 (c) of the 1924 Act, *supra*, reading: "In the case of estates of incompetent, deceased, or insolvent persons," the 1926 Act substituted: "For any period an estate is held by a fiduciary appointed by order of any

court of competent jurisdiction or by will." This amendment was made and explained on the floor of the Senate, and the reasons given make clear the Congressional intent that interest run against a fiduciary estate on preexisting tax claims until paid, as follows (67 Cong. Rec., Part 3, pp. 3377–3378):

> Mr. REED of Pennsylvania. Mr. President, the purpose of this amendment and of the three amendments which follow it is to take care of this situation:
>
> Under the bill as passed by the House there is some doubt as to whether the reduced rate of interest provided in this subdivision is applicable only in cases where the tax is imposed upon the estate, or whether it also includes cases where the estate is called upon to pay interest for the period before the estate came under the control of the fiduciary.
>
> For example, if notice is given and demand made upon a taxpayer, and he is delinquent in payment and dies, can there be collected out of the estate interest at the rate of 12 percent down to the time of his death? It seems to the committee that in such a case the relief provided in this subdivision should cover only the period when the property is under the control of the fiduciary.
>
> There is also some doubt as to what estates are included in the provisions of the House bill. The amendment now offered seeks to make it clear that the provision applies in

every case where an estate is held by a fiduciary appointed by a court or by will.

The House accepted the Senate amendment, as the following excerpt from the Conference Report shows (H. Rep. No. 356, 69th Cong., 1st Sess., p. 41 (1939–1 Cum. Bull. (Part 2) 361, 369)):

> Amendment No. 69: The House bill retained the existing law and provided that in the case of estates of incompetent, deceased, and insolvent persons there should be collected interest at the rate of 6 percent a year in lieu of interest at the rate of 1 percent a month for delinquencies in payment of taxes.
>
> Under the existing law there is considerable doubt whether the reduced rate of interest provided is applicable only to cases where the tax is imposed upon the estate, or also includes cases where an estate is called upon to pay interest for the period before the estate came under the control of the fiduciary, for example, if notice and demand is made upon the taxpayer, and he is delinquent in payment, and dies, can there be collected out of the estate interest at the rate of 1 percent a month down to the time of his death? Under the existing law there is also the difficulty of determining with accuracy the time when a person becomes incompetent or insolvent. The Senate amendment met the above difficulties by providing that the reduced interest rates should cover only the period when the property is under the control of a fiduciary

> appointed by order of any court of competent jurisdiction or by will. The House recedes.

Section 276 (c) of the Revenue Act of 1926 became Section 294 (c) of the Revenue Act of 1928, c. 852, 45 Stat. 791, and was continued without substantial change through successive revenue acts until the Revenue Act of 1938, including, as we have seen, the controlling Revenue Acts of 1934 and 1936.

In the Revenue Act of 1928, Section 701 (a) (5), the following definition appears:

> (5) The term "fiduciary" means a guardian, *trustee,* executor, administrator, receiver, conservator, or any person acting in any fiduciary capacity for any person. [Italics supplied.]

This definition is continued without change in the controlling Acts of 1934 as Section 801 (a) (6), and of 1936, Section 1001 (a) (6). *In re Semon, supra,* specifically held that a trustee in bankruptcy was a fiduciary within this definition.

It will be noted, Appendix B, *infra,* p. 43, that Section 404 of the Revenue Act of 1935 reduced the interest rate in the case of any internal revenue tax or customs duty to 6 percent. Hence, Section 294 (c) of the 1934 and 1936 Acts, respectively, became surplusage and was omitted when the 1938 Revenue Act was passed, as explained by the following quotation from the House Committee Report (H. Rep. No. 1860, 75th Cong., 3d Sess., p. 49 (1939–1 Cum. Bull. (Part 2) 728, 763)):

SECTION 294. FIDUCIARIES

Section 294 (c) of the Revenue Act of 1936 is not retained in this bill, since it is clearly surplusage. Prior to the enactment of section 404 of the Revenue Act of 1935, reducing the rates of interest on unpaid taxes from 1 percent per month to 6 percent per annum, the matter eliminated provided a special rule in the case of estates held by fiduciaries appointed by courts of competent jurisdiction or by will. Now that all unpaid taxes bear interest at the rate of 6 percent per annum, there is no further need for continuing the matter eliminated, and the interest rate in such cases is governed by other provisions of section 294.

Moreover, further confirmation of the Government's position is to be found in the provision contained in successive Revenue Acts prescribing the procedure for filing income tax claims in bankruptcy which originated with Section 282 of the Revenue Act of 1926, c. 27, 44 Stat. 9, and has been substantially reenacted in each successive revenue statute up to the present time. Section 274, Revenue Acts of 1928, c. 852, 45 Stat. 791; 1932, c. 209, 47 Stat. 169; 1934, c. 277, 48 Stat. 680; 1936, c. 690, 49 Stat. 1648, and Internal Revenue Code. In originally proposing this provision as part of the 1926 Act, the House Conference Report stated, *inter alia*, H. Rep. No. 356,

69th Cong., 1st Sess., p. 46 (1939–1 Cum. Bull. (Part 2) 361, 373):

> Interest for any period during which the estate of the taxpayer is under the control of the trustee or receiver appointed by the equity or bankruptcy court is provided at the rate of 6 percent a year in lieu of 1 percent a month in certain cases by sections 276 (e) and 279 (j).

Again, the Treasury Regulations, which throughout this period implemented these successive statutes, have explicitly provided at all times that the Government's tax claims in bankruptcy shall include interest to the date of payment. Thus in Treasury Regulations 69, promulgated under the Revenue Act of 1926, Article 1294, the following appears:

> A copy of the notification letter will be attached to the assessment list as the collector's authority for filing claim in bankruptcy or receivership for the amount represented by the assessment, plus interest at the rate of 6 percent per annum for the period from the date of filing claim by the collector to the date of termination of the bankruptcy or receivership proceeding, or to the date of payment if payment is made in full prior to such termination. * * *

This provision has been in substance repeated in the Treasury Regulations in succeeding Revenue Acts. Treasury Regulations 74, promulgated un-

der the Revenue Act of 1928, Art. 1192; Treasury Regulations 77, promulgated under the Revenue Act of 1932, Art. 1192; Treasury Regulations 86, promulgated under the Revenue Act of 1934, Art. 274–2; Treasury Regulations 94, promulgated under the Revenue Act of 1936, Art. 274–2. In Treasury Regulations 101, promulgated under the Revenue Act of 1938, c. 289, 52 Stat. 447, approved February 7, 1939, subsequent to enactment of the Chandler Act the same language is continued without material change as follows:

> ART. 274–1. *Bankruptcy and receivership proceedings.*—* * *
>
> * * * * * * *
>
> * * * Such claim should cover the amount represented by the assessment, plus interest at the rate of 6 percent per annum for the period from the date of filing claim by the collector to the date of termination of the bankruptcy or receivership proceeding or to the date of payment if payment is made in full prior to such termination. * * *

The quoted provision is repeated in Treasury Regulations 103, Section 19.274–1, promulgated under the Internal Revenue Code and Treasury Regulations 111, Section 29.274–1, likewise promulgated under the Internal Revenue Code.

To summarize, the foregoing legislative history establishes that over a period of many years Congress understood that tax claims against estates held by fiduciaries, including bankruptcy,

trustees, bore interest until paid. Although these statutory provisions above discussed refer specifically to income taxes, there is no reason to suppose that claims for the other taxes here involved, namely, social security and capital stock taxes, were intended to be treated in any different manner.

Of course, this development of special interest provisions for fiduciary estates, commencing as it did in 1924, could not have been a factor in the 1923 decision of the court below in *In re J. Menist & Co., supra*, or in its affirmance by this Court in 1924 *sub nomine United States* v. *Childs, supra*. Obviously, it strongly confirms the result of those cases.

Again, the Chandler Act and the Revenue Act of 1938 were enacted by the same Congress (75th Congress, 3d Sess.), and within a month of each other,[1] and the above-quoted legislative history of the 1938 Revenue Act, *supra*, pp. 19–20, evidences that Congress continued to maintain the same policy as under the earlier revenue acts with respect to imposition of interest on tax claims against estates held by fiduciaries. Moreover, the Bankruptcy Act and the revenue acts, so far as they deal with interest on tax claims against bankrupt estates, are *in pari materia*. Hence, upon well settled principles, wherever possible, they

[1] The Chandler Act approved June 22, 1938; the Revenue Act of 1938, passed May 16, 1938, became a law without presidential approval.

are to be construed consistently so as to give effect to the provisions of both.[8] Here it is submitted that the Bankruptcy Act provisions correctly construed are clearly consistent with the pertinent provisions of the several revenue acts above discussed and here controlling. Indeed, the congressional purpose clearly evident in the revenue acts surely confirms the construction of the Bankruptcy Act for which the Government here contends.

Further, contrary to the statement contained in the opinion of the court below in the *Saper* case (Pet. p. 24, footnote 8), the Government does not imply by its argument in this connection that the Bankruptcy Act intended to treat federal tax claims more advantageously than state or municipal tax claims; rather, our contention is that the federal revenue legislation affords further support to the congressional purpose which we find expressed by the Bankruptcy Act, namely, to impose as part of the tax interest accruing after bankruptcy.

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[8] So Congress explicitly recognized in Section 902 (i) of the Social Security Act Amendments of 1939, reading as follows:

"(i) No part of the tax imposed by the Federal Unemployment Tax Act or by title IX of the Social Security Act, whether or not the taxpayer is entitled to a credit against such tax, shall be deemed to be a penalty or forfeiture within the meaning of section 57j of the Act entitled 'An Act to establish a uniform system of bankruptcy throughout the United States,' approved July 1, 1898, as amended."

See *United States* v. *New York*, 315 U. S. 510, 517, footnote 9.

II

NOTHING IN THE 1938 AMENDMENTS TO THE BANKRUPTCY ACT JUSTIFIES THE CONCLUSION THAT THE CONGRESS INTENDED TO CHANGE THE ESTABLISHED RULE THAT INTEREST ACCRUES ON TAX CLAIMS DURING BANKRUPTCY

The decision of the court below is based upon the proposition that Congress, by the "assimilation of tax claims to other debts" (*Saper* v. *City of New York*, 168 F. 2d at 270), intended also that tax claims, like other debts, should not bear interest during bankruptcy. This is the precise point of conflict with *Davie* v. *Green*, in which the Court of Appeals for the First Circuit rejected that proposition and held that the reenactment of Section 57j without substantial change amounted to Congressional adoption of the existing rule as to interest derived from that section. 133 F. 2d at 453. We submit that the view of the Court of Appeals for the First Circuit is correct.

A. THE 1938 AMENDMENTS TO THE BANKRUPTCY ACT WERE ENTIRELY PROCEDURAL IN THEIR IMPACT ON TAX CLAIMS, AND CANNOT SUPPORT THE INFERENCE THAT CONGRESS INTENDED TO CHANGE THE RULE ALLOWING INTEREST ON SUCH CLAIMS DURING BANKRUPTCY

The "assimilation of tax claims to other debts" referred to by the court below consists of the 1926 and 1938 amendments to Section 64 and the 1938 amendment to Section 57n. Prior to 1926, Section 64 (a) provided that "the court shall order the trustee to pay all taxes legally due and

owing by the bankrupt to the United States, State, county, district, or municipality in advance of the payment of dividends to creditors." In practice, this was construed to require the payment of tax claims ahead of all other claims except administration expenses. *In re A. E. Fountain, Inc.*, 295 Fed. 873, 876 (S. D. N. Y.); 6 Remington on Bankruptcy (4th ed., 1937) 335–336. In 1926, Section 64 (a) was amended to delete the words "in advance of the payment of dividends to creditors" and to substitute the words "in the order of priority as set forth in paragraph (b)"; under Section 64 (b) tax claims were listed after four classes of administration expenses and after three-month wage claims. The practical result of these amendments was to overrule the decision in *Oliver* v. *United States*, 268 U. S. 1, construing Section 64 as requiring payment of tax claims before wage claims. In other words, by the 1926 amendments, tax claims lost their position immediately after administration expenses, and were subordinated to three-month wage claims as well. However, the courts continued to allow interest on tax claims during bankruptcy after the 1926 amendment of Section 64. *Horn* v. *Boone County, supra; In re Semon, supra.*

The 1938 amendments to Sections 64 and 57n [9] made just one change with respect to tax claims—

[9] The following shows the changes in Sections 57n, 64a and b of the Bankruptcy Act of 1898, so far as pertinent, by the Chandler Act. The matter in brackets represents the

they relieved the trustee in bankruptcy of the burden of searching out tax claims by requiring that such claims be filed and proved in the same manner as other claims. This was merely a procedural change—adopted for the sole purpose of

portion of the old section that has been deleted. The matter in italics represents additions made by the Chandler Act. The remainder is unchanged.

"SEC. 57. PROOF AND ALLOWANCE OF CLAIMS.

* * * * *

"n. *Except as otherwise provided in this Act, all claims provable under this Act, including all claims of the United States and of any State or subdivision thereof, shall be proved and filed in the manner provided in this section. Claims which are not filed within six months after the first date set for the first meeting of creditors shall not be allowed: Provided, however, That the court may, upon application before the expiration of such period and for cause shown, grant a reasonable fixed extention of time for the filing of claims by the United States or any State or subdivision thereof:* * * *.

* * * * *

"[n. Claims shall] not be proved against a bankrupt estate subsequent to six months after the adjudication; or if they are liquidated by litigation and the final judgment therein is rendered within thirty days before or after the expiration of such time, then within sixty days after the rendition of such judgment * * *.]

"SEC. 64. DEBTS WHICH HAVE PRIORITY.

"[a. The court shall order the trustee to pay all taxes legally due and owing by the bankrupt to the United States, State, county, district, or municipality, in the order of priority as set forth in paragraph (b) hereof: *Provided*, That no order shall be made for the payment of a tax assessed against real estate of a bankrupt in excess of the value of the interest of the bankrupt estate therein as determined by the court. Upon filing the receipts of the proper public officers for such payments the trustee shall be credited with the amounts thereof, and in case any question arises as to the amount or

speeding up administration. H. Rep. No. 1409, 75th Cong., 1st Sess. (1937) 13; S. Rep. No. 1916, 75th Cong., 3d Sess. (1938) 5. Moreover, subjecting tax claims to a requirement of timely filing added nothing new to bankruptcy administration; rather, as pointed out by Judge Coxe in *In re Spotlight Productions,* 75 F. Supp. 458, 459 (S. D. N. Y.), it simply codified the judicially-devised bar order which achieved the same result. *New York* v. *Irving Trust Co.,* 288 U. S. 329; 3 Collier on Bankruptcy (14th ed., 1941) 327–328.

There are several reasons why this procedural amendment of 1938 cannot support the inference of the court below that Congress intended to abrogate the rule that tax claims bear interest during bankruptcy. First, the Chandler Act amendments to the Bankruptcy Act represented a most thorough-going reexamination of the lat-

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legality of any such tax the same shall be heard and determined by the court.]

"*a.* [b] The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment shall be * * *

* * * * * *

"(4) [(6)] taxes [payable under paragraph (a) hereof] *legally due and owing by the bankrupt to the United States or any State or any subdivision thereof: Provided, That no order shall be made for the payment of a tax assessed against any property of the bankrupt in excess of the value of the interest of the bankrupt estate therein as determined by the court; and provided further, That, in case any question arises as to the amount or legality of any taxes, such question shall be heard and determined by the court;* * *"

ter Act (H. Rep. 1409, *ibid.*, p. 2). In fact, it is impossible to assume that the draftsmen were unaware of the interest rule based upon Section 57j, because this rule, applicable as it is to federal, state and local tax claims, is involved in nearly every bankruptcy proceeding. In particular, Congress did not overlook Section 57j, but as a matter of fact, reenacted the complete section in the Chandler Act with a minor verbal change. See page 9, *supra*. Had it intended to overthrow the settled rule with respect to interest on tax claims, it seems reasonable to suppose that it would have manifested explicitly its purpose to change the established pre-existing law. In adopting language used in an earlier act, Congress is presumed to adopt also the construction given by the courts and by itself (in revenue legislation, *supra*, pp. 15–24) over a period of many years prior to the reenacted language. *Hecht* v. *Malley*, 265 U. S. 144, 153; *United States* v. *Ryan*, 284 U. S. 167, 174–175. *Helvering* v. *Hallock*, 309 U. S. 106, 119–121, cited by the District Court in this connection (R. 15–16), is not apposite, for in the *Hallock* case there was not, as here, a reenactment of the questioned statutory language (particularly Section 57j) subsequent to long and uniform administrative, judicial and legislative construction. In the *Hallock* case, Congress was silent after the judicial construction relied upon. Here, on the contrary, in the

Chandler Act itself, Congress reenacted the statute.

Secondly, the rule as to interest on tax claims applies to state and local taxes as much as it does to federal taxes. We believe that an intention to make a change in the law adverse to State and local governments should not be ascribed to Congress in the absence of far more persuasive evidence than is afforded by the 1938 amendments. Cf. *Swarts* v. *Hammer*, 194 U. S. 441, 444.

Finally, the decision below has, contrary to the well-settled principle, rested a tax exemption upon mere implication. Procedural assimilation of tax claims in bankruptcy with ordinary contract debts cannot disguise their difference in essential nature. The power to tax is an indispensable attribute of sovereignty, absolutely necessary for the support of the government, maintenance of law and order, and protection of life and property. Unlike his contract debts, the bankrupt's tax obligation is imposed without his consent and for the common welfare. *New Jersey* v. *Anderson*, 203 U. S. 483, 492; *United States* v. *New York, supra*, 315 U. S. 510, 515–516; *United States* v. *Bernstein*, 16 F. 2d 233, 234–235 (C. C. A. 8). In the case of a tax obligation, the obligor has not passed upon the debtor's credit and thus in a sense assumed the risk. Taxes are civil obligations, not personal conventions. *Guarantee Co.* v. *Title Guaranty Co.*,

224 U. S. 152, 160. Again, as this Court stated in *United States* v. *Childs*, *supra*, p. 308:

> The imposition of a tax is certainly a function of government and creates an obligation, and the power that creates the obligation can assign the measure of its delinquency—the detriment of delay in payment * * *.

The interest imposed as detriment for the delay in payment here is under the governing statutes, as much a part of the tax as the principal itself and rests (*Rodgers* v. *United States*, 332 U. S. 371, 374)—

> on the basic necessity of the Government to collect a carefully estimated sum of money by a particular date in order to meet its anticipated expenditures.

What this necessity is and what sum of money is required to meet it, is surely a matter peculiarly within the knowledge and province of the legislature and not the judiciary. Hence, the rule is fundamental that Congress alone possesses the power to grant a tax exemption and where granted, it is expressed, never implied.

Early in the history of the Bankruptcy Act of 1898, this Court held that nothing in that statute exempts property in the hands of a bankruptcy trustee from state and municipal taxes to which similar property in the same locality is subject. The same reasoning applies to tax claims against the bankrupt estate arising prior to the

bankruptcy. Thus, in refutation of an argument similar to that advanced here, in *Swarts* v. *Hammer*, 194 U. S. 441, 444, this Court said:[10]

> By the transfer to the trustee no mysterious or peculiar ownership or qualities are given to the property. It is dedicated, it is true, to the payment of the creditors of the bankrupt, but there is nothing in that to withdraw it from the necessity of protection by the State and municipality, or which should exempt it from its obligations to either. If Congress has the power to declare otherwise and wished to do so the intention would be clearly expressed, not left to be collected or inferred from disputable considerations of convenience in administering the estate of the bankrupt.

The principle there expressed, formulated with particular application to state and municipal taxes, applies *a fortiori* to taxes imposed by Con-

[10] In the cited case this Court referred with approval to the opinion there of the Circuit Court of Appeals below, in which the following language here also pertinent appears (*Swarts* v. *Hammer*, 120 Fed. 256, 257 (C. C. A. 8, 1903):

"* * * Exemption from taxation is never presumed. The legislative intent to exempt property from taxation must be clearly and explicitly expressed. Whether Congress could rightfully exempt from state taxation the property of a bankrupt in the hands of a trustee in bankruptcy, and otherwise subject to taxation, we need not inquire. It has not attempted to do so, and it is highly probable it never will. The power of taxation, as well as the power to exempt from taxation, is a legislative, and not a judicial, function; and a bankrupt court, no more than any other court, can exempt from taxation property in the hands of one of its officers which is liable to taxation under the state law."

gress. Thus, in *United States* v. *Stewart*, 311 U. S. 60, 71, this Court said:

> In that posture of the case, respondent has succeeded only in casting some doubt on the proper construction of the statute. Yet those who seek an exemption from a tax must rest it on more than a doubt or ambiguity. *Bank of Commerce* v. *Tennessee*, 161 U. S. 134, 146; 163 U. S. 416, 423. Exemptions from taxation cannot rest upon mere implications. *United States Trust Co.* v. *Helvering*, 307 U. S. 57, 60.

In the instant case, the codifying procedural amendment of 1938 with respect to tax claims provide no basis for inferring a new cause for tax exemption or forgiveness.

To summarize, we believe that the presumption which flows from reenactment of a statutory provision after thorough reconsideration, together with the rule against implication of tax exemptions, precludes any inference that Congress by the procedural amendment of 1938 intended to change the rule that interest accrues on tax claims during bankruptcy.[11]

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[11] As a matter of fact, with the exception of claims based upon fixed liability evidenced by judgment or written instrument (Bankruptcy Act, Section 63a (1) and (5)), the statute does not express the rule generally applied to claims of private creditors, denying interest after the date of bankruptcy. This rule, as noted in the opinion of the court below in the *Saper* case (Pet. pp. 18–19), was developed in equity following English practice. *Sexton* v. *Dreyfus*, 219 U. S. 339, 344. Actually, the rule does not prevent the run-

B. THAT THE 1938 AMENDMENTS DID NOT CHANGE THE FORMER RULE IS CONFIRMED BY SUBSEQUENT CONGRESSIONAL UNDERSTANDING IN AN UNSUCCESSFUL EFFORT TO AMEND SECTION 57j

The history of H. R. 5693 in the last session of Congress indicates conclusively the understanding of Congress that by the 1938 amendments to the Bankruptcy Act it had not changed the established rule allowing interest on tax claims during bankruptcy. Section 11 of this bill, which was passed by the House of Representatives on June 8, 1948 (94 Cong. Rec. 7569–7572), would have amended Section 57j by adding a new paragraph, as follows:

> (2) Except where the estate of the bankrupt is solvent, interest accruing after the date of bankruptcy on taxes legally due and owing to the United States or to any State or any subdivision thereof shall not be allowed.

The Senate did not act upon the bill. The House action alone would be convincing evidence of the Congressional understanding that the rule allowing such interest was not changed by the 1938 amendments. However, this is not left to inference, because the report of the House Com-

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ning of interest during bankruptcy, and if the estate proves sufficient to discharge all claims in full, interest as well as principal is paid. *Am. Iron Co.* v. *Seaboard Air Line*, 233 U. S. 261, 266–267; *Johnson* v. *Norris*, 190 Fed. 459 (C. C. A. 5), certiorari denied, 232 U. S. 723. Thus, here, the court below has allowed a tax exemption, not by virtue of the command of the statute but by its own extension of a rule developed judicially.

mittee on the Judiciary (H. Rep. No. 2083, 80th Cong., 2d Sess. (1948), 5) specifically states:

> * * * The addition of clause (2) in the bill is intended to overrule an obsolete rule as to interest on delinquent tax debts. Interest on general unsecured debts, on unsecured Government debts other than taxes, and on debts entitled to priority under section 64a, is suspended at the date of bankruptcy so that, except in the rare case of a solvent estate, interest is allowable only to such date. * * * However, interest on delinquent tax debts is allowable to the date of payment * * *. Although, under the Chandler Act, a tax debt is required to be proved (sec. 57n) and its order of priority ranks below all administration costs and expenses, wages and costs and expenses of creditors successfully opposing a settlement or discharge, or procuring a conviction for an offense (sec. 64a (1) (2), (3)), thereby rendering obsolete the reasoning in the *Kallak* case, *nevertheless its rule has not been changed and therefore requires this statutory modification.* * * * And on overruling the *Kallak* case see *In re Union Fabrics, Inc.* (S. D., N. Y., 1947), 73 F. Supp. 685, appeal pending. [Italics supplied.] [12]

[12] The House Committee report (p. 5) also refers to the approval by the Judicial Conference of this amendment to Section 57j. In the Report of the Judicial Conference dated November 7, 1944 (p. 9), the Conference stated its approval of the recommendation of its Committee on Bankruptcy: "* * * that § 57j be amended to stop the running of

This is compelling evidence that Congress did not intend by the 1938 amendments to the Bankruptcy Act to change the rule allowing interest on tax claims during bankruptcy; to the contrary, Congress has specifically recognized that further legislation is necessary to change that rule.[12]

CONCLUSION

The decision of the Court of Appeals for the Second Circuit should be reversed.

Respectfully submitted.

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NOVEMBER 1948.

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interest and penalties on tax claims at the date of the filing of the petition in bankruptcy or debtor proceeding; * * *" This recommendation was renewed in the 1945 and 1946 sessions of the Conference. Report of the Judicial Conference, September Session, 1945 (pp. 16–17); Report of the Judicial Conference, October Session, 1946 (p. 15).

[12] The judgments of the court below in the instant case and in the related *Saper* case were rendered on May 25, 1948, while the report of the House Committee on the Judiciary was issued three days later on May 28. Thus, this material was not available to the court below.

APPENDIX A

Bankruptcy Act of 1898, c. 541, 30 Stat. 544:

SEC. 17 [as amended by the Act of June 22, 1938, c. 575, 52 Stat. 840, Sec. 1]. DEBTS NOT AFFECTED BY A DISCHARGE.—a. A discharge in bankruptcy shall release a bankrupt from all of his provable debts, whether allowable in full or in part, except such as (1) are due as a tax levied by the United States, or any State, county, district, or municipality; * * *.

(11 U. S. C. 1946 ed., Sec. 35.)

SEC. 57. PROOF AND ALLOWANCE OF CLAIMS.

* * * * * *

j. [as amended by the Act of June 22, 1938, c. 575, 52 Stat. 840, Sec. 1]: Debts owing to the United States or any State or subdivision thereof as a penalty or forfeiture shall not be allowed, except for the amount of the pecuniary loss sustained by the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interest as may have accrued thereon according to law.

* * * * * *

n. [as amended by the Act of May 27, 1926, c. 406, 44 Stat. 662, Sec. 13; Act of June 22, 1938, c. 575, 52 Stat. 840, Sec. 1]. Except as otherwise provided in this Act, all claims provable under this Act, including all claims of the United States and of any State or subdivision thereof, shall be proved

and filed in the manner provided in this section. Claims which are not filed within six months after the first date set for the first meeting of creditors shall not be allowed: *Provided, however*, That the court may, upon application before the expiration of such period and for cause shown, grant a reasonable fixed extension of time for the filing of claims by the United States or any State or subdivision thereof: * * *. (11 U. S. C. 1946 ed., Sec. 93.)

SEC. 64 [as amended by the Act of May 27, 1926, c. 406, 44 Stat. 662, Sec. 15; Act of June 22, 1938, c. 575, 52 Stat. 840, Sec. 1; Act of June 28, 1946, c. 512, 60 Stat. 323, Sec. 12]. DEBTS WHICH HAVE PRIORITY.

a. The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment, shall be (1) the actual and necessary costs and expenses of preserving the estate subsequent to filing the petition; the fees for the referees' salary fund and for the referees' expense fund; the filing fees paid by creditors in involuntary cases; where property of the bankrupt, transferred or concealed by him either before or after the filing of the petition, shall have been recovered for the benefit of the estate of the bankrupt by the efforts and at the cost and expense of one or more creditors, the reasonable costs and expenses of such recovery; the costs and expenses of administration, including the trustee's expenses in opposing the bankrupt's discharge, the fees and mileage payable to witnesses as now or hereafter provided by the laws of the United States, and one reasonable attorney's fee, for the professional services actually rendered, ir-

respective of the number of attorneys employed, to the petitioning creditors in involuntary cases and to the bankrupt in voluntary and involuntary cases, as the court may allow; (2) wages, not to exceed $600 to each claimant, which have been earned within three months before the date of the commencement of the proceeding, due to workmen, servants, clerks, or traveling or city salesmen on salary or commission basis, whole or part time, whether or not selling exclusively for the bankrupt; (3) where the confirmation of an arrangement or wage-earner plan or the bankrupt's discharge has been refused, revoked, or set aside upon the objection and through the efforts and at the cost and expense of one or more creditors, or, where through the efforts and at the cost and expense of one or more creditors, evidence shall have been adduced resulting in the conviction of any person of an offense under this Act, the reasonable costs and expenses of such creditors in obtaining such refusal, revocation, or setting aside, or in adducing such evidence; (4) taxes legally due and owing by the bankrupt to the United States or any State or any subdivision thereof: *Provided*, That no order shall be made for the payment of a tax assessed against any property of the bankrupt in excess of the value of the interest of the bankrupt estate therein as determined by the court: *And provided further*, That, in case any question arises as to the amount or legality of any taxes, such question shall be heard and determined by the court; and (5) debts owing to any person, including the United States, who by the laws of the United States in [sic] entitled to priority, and rent owing to a

landlord who is entitled to priority by applicable State law: *Provided, however,* That such priority for rent to a landlord shall be restricted to the rent which is legally due and owing for the actual use and occupancy of the premises affected, and which accrued within three months before the date of bankruptcy.

(11 U. S. C. 1946 ed., Sec. 104.)

APPENDIX B

(1) As to the claims for the unpaid social security taxes for the years 1936, 1937, 1938, and 1939, imposed under Title VIII of the Social Security Act, and Internal Revenue Code, Chapter 9, Subchapter A, Part III, the applicable statutory provisions read as follows:

> Social Security Act of 1935, approved August 14, 1935, c. 531, 49 Stat. 620:
>
> * * * * *
>
> SEC. 807. (a) * * * If the tax is not paid when due, there shall be added as part of the tax interest (except in the case of adjustments made in accordance with the provisions of sections 802 (b) and 805) at the rate of one-half of 1 per centum per month from the date the tax became due until paid.
>
> Internal Revenue Code:
>
> SEC. 1420. COLLECTION AND PAYMENT OF TAXES.
>
> * * * * *
>
> (b) *Addition to Tax in Case of Delinquency.*—If the tax is not paid when due, there shall be added as part of the tax interest (except in the case of adjustments made in accordance with the provisions of sections 1401 (c) and 1411) at the rate of 6 per centum per annum from the date the tax became due until paid.

As to the social security taxes imposed under Title IX of the Social Security Act, and Chapter 9, Subchapter C, of the Internal Revenue Code, the statutory provisions are substantially identical

with the above. Social Security Act, Sec. 905 (a); Internal Revenue Code, Sec. 1605 (b).

(2) As to the claim for unpaid income tax for 1935, imposed under the Revenue Act of 1934, the applicable statutory provisions read as follows:

> Revenue Act of 1934, c. 277, 48 Stat. 680:
>
> SEC. 294. ADDITIONS TO THE TAX IN CASE OF NONPAYMENT.
>
> (a) *Tax Shown on Return.*—
>
> (1) *General Rule.*—Where the amount determined by the taxpayer as the tax imposed by this title, or any installment thereof, or any part of such amount or installment, is not paid on or before the date prescribed for its payment, there shall be collected as a part of the tax, interest upon such unpaid amount at the rate of 1 per centum a month from the date prescribed for its payment until it is paid.
>
> * * * * *
>
> (c) *Fiduciaries.*—For any period an estate is held by a fiduciary appointed by order of any court of competent jurisdiction or by will, there shall be collected interest at the rate of 6 per centum per annum in lieu of the interest provided in subsections (a) and (b) of this section.

As to the claim for unpaid income tax for 1936, imposed under the Revenue Act of 1936, the applicable statutory provisions read as follows:

> Revenue Act of 1936, c. 690, 49 Stat. 1648:
>
> SEC. 294. ADDITIONS TO THE TAX IN CASE OF NONPAYMENT.
>
> (a) *Tax Shown on Return.*—
>
> (1) *General Rule.*—Where the amount determined by the taxpayer as the tax

imposed by this title, or any installment thereof, or any part of such amount or installment, is not paid on or before the date prescribed for its payment, there shall be collected as a part of the tax, interest upon such unpaid amount at the rate of 6 per centum per annum from the date prescribed for its payment until it is paid.

* * * * * *

(c) *Fiduciaries.*—For any period an estate is held by a fiduciary appointed by order of any court of competent jurisdiction or by will, there shall be collected interest at the rate of 6 per centum per annum in lieu of the interest provided in subsections (a) and (b) of this section.

(3) As to the claim for unpaid capital stock tax for 1935, imposed under the Revenue Act of 1934, the applicable statutory provisions read as follows:

Revenue Act of 1934, c. 277, 48 Stat. 680:
SEC. 701. CAPITAL STOCK TAX.

* * * * * *

(d) * * * If the tax is not paid when due, there shall be added as part of the tax interest at the rate of 1 per centum a month from the time when the tax became due until paid. * * *

See also Revenue Act of 1935, c. 829, 49 Stat. 1014, Section 404, reading as follows:

SEC. 404. INTEREST ON DELINQUENT TAXES.

Notwithstanding any provision of law to the contrary, interest accruing during any period of time after the date of the enactment of this Act upon any internal-revenue tax (including amounts assessed or collected as a part thereof) or customs duty, not paid when due, shall be at the rate of 6 per centum per annum.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1948.

No. 200.

STATE OF NEW YORK,
Petitioner,

200

vs.

LEONARD H. CARTER, as Trustee in Bankruptcy.

No. 201.

THE UNITED STATES OF AMERICA,
Petitioner,

201

vs.

LEONARD H. CARTER, Trustee of Union Fabrics, Inc.,
Bankrupt.

ON WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR RESPONDENT.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1948.

No. 200.

STATE OF NEW YORK,
Petitioner,

vs.

LEONARD H. CARTER, as Trustee in Bankruptcy.

No. 201.

THE UNITED STATES OF AMERICA,
Petitioner,

vs.

LEONARD H. CARTER, Trustee of Union Fabrics, Inc., Bankrupt.

BRIEF FOR RESPONDENT.

Statement.

The case at bar and its companion case *Saper* v. *City of New York*, 168 F. (2d) 268 (C. C. A. 2, 1948), are the first since the amendments of the Bankruptcy Act in 1938 which directly present to this Court the question as to whether interest is allowable on priority tax claims in bankruptcy for the period subsequent to the filing of the petition in bankruptcy where there is no surplus.

Summary of Argument.

Petitioners have failed to prove that there is any statutory authority for allowance of interest on tax claims in bankruptcy after the date of the filing of the petition in bankruptcy. Section 57j of the Bankruptcy Act relied upon by petitioners is wholly irrelevant. *A fortiori*, the federal taxing statutes cited by the United States to support petitioners' construction of Section 57j are also irrelevant. The cases cited by petitioners, with the sole exception of *Davie v. Green*, 133 F. (2d) 451 (C. C. A. 1, 1943), which is founded upon an erroneous premise, do not support the proposition for which they are cited.

The rule urged by petitioners was of judicial origin. The only reasons stated in the cases, decided prior to the Chandler Act, for the allowance of interest on tax claims during bankruptcy were the favored status of tax claims under the Bankruptcy Act and administrative convenience. The amendments of the Bankruptcy Act in 1926 and particularly in 1938 (Chandler Act) rendered those reasons obsolete. The report of the House Committee on the Judiciary cited by petitioners concurs in that conclusion. Petitioners' other arguments to the contrary are insufficient. The only remaining issue therefore is whether the obsolete rule should be abrogated by this Court or whether it requires congressional action at some indefinite future time. Precedent and reason indicate that this Court should abrogate this rule of judicial origin in order to prevent the perpetuation of further inequities, inconsistencies and anomalies resulting from its application.

Bankruptcy courts have inherent and statutory equitable powers to disallow claims, in whole or in part,

on equitable grounds whether or not this Court determines to abrogate the rule urged by petitioners, the equitable considerations of the instant case are such as to require the exercise of the Court's discretion to disallow petitioners' claims to the extent of interest for the period subsequent to the filing of the petition in bankruptcy.

Argument.

I.

No statutory authority exists for the payment of interest on tax claims in bankruptcy for the period subsequent to the date of bankruptcy.

1. Irrelevancy of Section 57j:

The briefs of petitioners are permeated with the fundamental fallacy that Section 57j of the Bankruptcy Act directs allowance of interest on tax claims in bankruptcy for the period subsequent to the date of the filing of the petition in bankruptcy (Brief for the United States, pp. 6, 7, 9-14, 25; Brief for New York, pp. 5, 8-10).

Section 57j (11 U. S. C., Sec. 93j) provides:

> "Debts owing to the United States or any State or subdivision thereof as a *penalty or forfeiture*[1] shall not be allowed, except for the amount of the pecuniary loss sustained by the act, transaction, or proceeding out of which the penalty or forfeiture arose, with reasonable and actual costs occasioned thereby and such interest as may have accrued thereon according to law."

[1] Italics in this and all subsequent quotations herein ours unless otherwise indicated.

Both petitioners construe the foregoing unambiguous language as though it covered all debts owing to the United States or any State or subdivision thereof and as though it required payment of interest on all such debts subsequent to the date of bankruptcy.

Clearly Section 57j relates only to debts owing as a "penalty or forfeiture". No need to invoke the interest provision can ever arise unless, as a condition precedent, the debt is one for a penalty or forfeiture.

Section 57j has no relevancy whatever to any case such as the instant case where there is no question of a penalty or forfeiture.

> *People of the State of New York* v. *Jersawit*, 263 U. S. 493 (1924);
> *United States* v. *Childs*, 266 U. S. 304 (1924);
> *Meilink* v. *Unemployment Reserves Commission of California*, 314 U. S. 564 (1942).

Accordingly the allowance of interest on tax claims cannot be justified by any of the provisions of Section 57j.

2. Analysis of Cases Cited to Support Petitioners' Construction of Section 57j:

The United States and the State of New York have expressly asserted that the federal courts have "repeatedly found in Section 57j the command that interest shall be allowed on tax claims during bankruptcy and until the date of payment" (Brief for the United States, p. 13) and that "interest on tax claims to the date of payment was allowed under the authority of Section 57j" (Brief for New York, p. 5).

Only one of the cases cited by petitioners supports such contentions (*Davie* v. *Green*, 133 F. (2d) 451

(C. C. A. 1, 1943). That decision in so far as it determines that interest on tax claims in bankruptcy is allowable to the date of payment, is founded on an erroneous premise. The primary question before that Court was whether the New Hampshire unemployment compensation statute provision for interest at the rate of 1% a month was a penalty or interest. That Court held that the impost was interest and not a penalty. Nevertheless, it paradoxically went on to rely on the language of Section 57j to hold that, in bankruptcy, interest on unpaid taxes continues until the date of payment.

Respondent has hereinbefore demonstrated that Section 57j has no application to the question of interest on tax claims in bankruptcy unless the debt involves a penalty or forfeiture. Section 57j was therefore irrelevant to the decision on the interest aspect of the *Davie* case since the first holding in that case was that the impost was not a penalty but interest.

The argument of the Court of Appeals in *Davie* v. *Green, supra,* adopted by petitioners, that since there was no material amendment of Section 57j in 1938, Congress intended to re-enact the prior rule of allowance of interest on tax claims to the date of payment, is therefore without foundation.[2]

The United States cites *In re J. Menist & Co.*, 290 Fed. 947 (C. C. A. 2, 1923), as the leading case and the decision of this Court in the same case *sub nomine United States* v. *Childs*, 266 U. S. 304 (1924), in support of petitioners' construction of Section 57j.

[2] See *Saper* v. *City of New York, supra*, pp. 270-271, from which it appears that there is no evidence to indicate that the problem was ever under consideration by Congress at the time of or prior to the enactment of the Chandler Act.

Respondent respectfully disagrees. In the *Menist* case the United States filed a claim in bankruptcy for the amount of income taxes in default plus 5% penalty and 1% interest per month until paid. Subsequently the United States withdrew its claim for the penalty of 5%. The District Court held that the interest of 1% a month amounted to a penalty and allowed the claim in the amount of the taxes in default, with interest at 6% to the date of payment. In affirming, the Court of Appeals cited Section 57j and held that exaction of 1% a month amounted to a penalty to the extent of anything in excess of the legal rate of interest.

In the *Menist* case, therefore, the Court of Appeals properly held that Section 57j was applicable because it found the exaction to include a penalty, much as this Court later held in the case of *People of the State of New York* v. *Jersawit*, 263 U. S. 493 (1924). Moreover it should be noted that the Court of Appeals allowed 6% of the amount of the taxes in default as "the pecuniary loss" sustained and not as "interest" provided for by Section 57j.

The *ratio* of that case is clear only when it is understood that the Court of Appeals was dealing with a bankruptcy claim for a penalty. Nothing in the *Menist* decision justifies the conclusion of petitioners that Section 57j directs or authorizes payment of interest on tax claims as such after the date of the bankruptcy.

On appeal, this Court did not approve petitioners' construction of Section 57j as petitioners allege. On the contrary, this Court held that the provision for interest of 1% a month was not a penalty but was interest. This Court quoted Section 57j of the Bank-

ruptcy Act only for consideration in connection with the clear and complete distinction made in the relevant tax statute between penalty and interest.

In reversing the judgment of the Court of Appeals in the *Monist* case, it is true that this Court allowed statutory interest to the date of payment. It did so, however, without discussing the question at bar. The *Childs* case was decided prior to the amendments to the Bankruptcy Act in 1926 and 1938, the effect of which are hereinafter discussed (pp. 13-17, *infra*). Nothing in this Court's opinion in the *Childs* case supports petitioners' construction of Section 57j.

None of the other cases cited by petitioners expressly or by implication refer to Section 57j as the basis for the allowance of interest after the filing of a petition in bankruptcy.[3]

3. Irrelevancy of Federal Taxing Statutes:

In determining the legality and priority of tax claims in bankruptcy, the Bankruptcy Act is paramount over all other federal and state statutes.

United States v. *New York*, 315 U. S. 510 (1942);
City of New York v. *Feiring*, 313 U. S. 283 (1941);
Missouri v. *Ross*, 299 U. S. 72 (1936);
Guarantee Title & Trust Co. v. *Title Guaranty & Surety Co.*, 224 U. S. 152 (1912);
In re Standard Composition Co., 23 F. Supp. 391 (E. D. Mich., 1938).

The United States, realizing this well settled doctrine, cites a number of federal taxing statutes only

[3] See 3 Collier on Bankruptcy (14th Ed.), p. 1841, n. 34, for a discussion of the cases.

as confirmatory of the petitioners' construction of Section 57j (Brief for the United States, p. 14).

Respondent has proved conclusively that Section 57j is irrelevant to the determination of the instant case since no penalty or forfeiture is involved. It necessarily follows therefore that the federal taxing statutes and regulations cited by the United States are also irrelevant.

In *Saper* v. *City of New York*, *supra*, the Court of Appeals answered this argument of the United States as follows (p. 271, n. 8):

> "In the companion case, the United States devotes much attention to various of the federal revenue laws and congressional debates as to changes in them with respect to interest against estates held by fiduciaries. But these do not offer any clear-cut solutions in themselves and are hardly available to change the stated priorities of a bankruptcy act. Obviously the intent of the latter is to treat federal, state, and municipal tax claims alike; it would be quite improper to accord the former alone some advantage based upon some newly discovered other federal law or regulation."

The determinative principle of law overlooked by the United States in citing its taxing statutes and regulations is that when bankruptcy occurs, the Bankruptcy Act supersedes all other federal statutes.[4]

---

[4] The Courts have consistently held, for example, that 31 U. S. C., Sec. 191, which gives the United States an absolute priority for its debts in cases of insolvency, does not control in bankruptcy proceedings since the Bankruptcy Act itself has established the order of priority of debts (*Davis* v. *Pringle*, 268 U. S. 315 (1925); *Guarantee Title & Trust Co.* v. *Title Guaranty & Surety Co.*, 224 U. S. 152 (1912); *In re Knox-Powell-Stockton Co.*, 100 F. (2d) 972 (C. C. A. 9, 1939).

4. Summary:

Petitioners have failed to prove that there is any statutory authority for allowance of interest on tax claims in bankruptcy after the date of the filing of the petition in bankruptcy.[5] Section 57j of the Bankruptcy Act relied upon by petitioners is wholly irrelevant. *A fortiori*, the federal taxing statutes cited by the United States to support petitioners' construction of Section 57j are also irrelevant. The cases cited by petitioners, with the sole exception of *Davie* v. *Green, supra*, which is founded upon an erroneous premise, do not support the proposition for which they are cited.

II.

The amendments of the Bankruptcy Act of 1938 have rendered obsolete the rule urged by petitioners.

1. Origin of the Rule:

The only expressed justification to be found in the cases decided prior to the Chandler Act for the allowance of interest on tax claims during the bankruptcy period was the favored status enjoyed by tax claims and administrative convenience.

In *Saper* v. *City of New York, supra*, the Court

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[5] Statutes involving priorities of claims in bankruptcy are strictly construed and the burden rests on the claimant asserting priority to establish that the claim asserted comes within the intended class (*In re Paradise Catering Corp.*, 36 F. Supp. 974 (S. D., N. Y., 1941); *In re Witt Dairy Co.*, 48 F. Supp. 964 (N. D., Cal., 1942); *In re Public Ledger*, 63 F. Supp. 1008 (E. D., Pa., 1945)).

of Appeals described the evolution of the rule and the reasons which prompted it as follows (p. 269):

> "For reasons both of administrative convenience and of fundamental justice and equity it has been steadily held, following the English practice, that interest does not accrue upon claims during the period of bankruptcy administration. *Sexton* v. *Dreyfus*, 219 U. S. 339, 344; *Vanston Bondholders Protective Committee* v. *Green*, 329 U. S. 156, 163, 165; 3 Collier, *loc. cit., supra.*[3] A single exception, that for tax claims, was developed judicially. It appears to have begun with *In re Kallak*, D. C. N. D., 147 F. 276, though the contemporaneous case of *In re William F. Fisher & Co.*, D. C. N. J., 148 F. 907, held to the contrary. But the *Kallak* case set the pattern and was followed by other cases, including *In re J. Menist & Co.*, 2 Cir., 290 F. 947, which, however, allowed interest only at the legal rate. When the Supreme Court reversed this holding to allow interest at the statutory rate, though without separate discussion of our particular problem, *United States* v. *Childs*, 1924, 266 U. S. 304, the matter was considered settled. The reason for the rule was that the original Bankruptcy Act treated tax claims quite differently from other debts; instead of requiring their presentation in due course, it provided that 'the court shall order the trustee to pay all taxes legally due and owing by the bankrupt to the United States, State, county, district, or municipality in advance of the payment of dividends to creditors.' § 64, sub. a, 11 U. S. C. A. § 104, sub. a, before amendment. Hence the trustee was, in effect, compelled to search them out. So taxes

were in altogether a separate class; they were to be paid before any administration of the estate, properly speaking, and thus had an absolute priority over the bankrupt's debts. In view of this peculiarly favored position, the like result as to interest was certainly not unnatural, even if not compelled.

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3 If, however, a sufficiency of assets develops, the claims will bear interest; and though the usual rule applies also to secured claims, yet where the security itself yields interest or dividends, those are applicable to interest on the claims. 3 Collier, *loc. cit. supra*."

The reasoning of the Court in *In re Kallak*, 147 Fed. 276 (D. C. N. D., 1906), was as follows (p. 277):

"There are two reasons why ordinary claims of creditors are not permitted to draw interest subsequent to the adjudication: First, it is important that the proportionate interest of the several creditors in the estate be ascertained and fixed. If interest were to accrue, however, after the adjudication, the amount of the several claims would vary from time to time, according to their respective rates of interest and the proportionate share of the several creditors would be subject to constant readjustment. The second reason is the convenience of administration. If, at the declaration of every dividend, a new basis of apportionment were required, depending upon varying rates of interest, the administration of the estate would be seriously complicated. *Chemical National Bank* v. *Armstrong*, 59 Fed. 372, 379, 8 C. C. A. 155, 28 L. R. A. 231; *White* v. *Knox*, 111 U. S. 784, 4 Sup. Ct. 686, 28 L. Ed. 603. In the case of public taxes, neither of these reasons

has any application because they do not share the estate with the claims of private creditors. On the contrary, section 64a expressly provides that before anything shall be paid to the creditors by way of dividends all taxes owing by the bankrupt shall be fully discharged. The reason for claims becoming fixed at the date of the adjudication, so that interest shall not subsequently accrue having no application to public taxes, the rule itself should not be applied in such cases."

The *ratio* of the *Kallak* case was, in our opinion, of doubtful validity since it contravened the fundamental bankruptcy principle that the assets of an insolvent estate constitute a trust fund *in custodia legis* and the delay in distribution is necessary for the orderly administration of the estate and should not operate to benefit or prejudice any creditor.

Thomas v. *Western Car Company*, 149 U. S. 95, 116 (1893);
Sexton v. *Dreyfus*, 219 U. S. 339, 344 (1911);
Vanston Committee v. *Green*, 329 U. S. 156, 163, 165 (1946).

Apparently the Courts which allowed interest on tax claims in bankruptcy to the date of payment in cases decided prior to *Davie* v. *Green, supra,* did so, with one immaterial exception,[6] either without discussion

[6] *In re Semon*, 11 F. Supp. 18 (D. C. Conn., 1935), mod. 80 F. (2d) 81 (C. C. A. 2, 1935). The District Court allowed interest during bankruptcy on the authority of Sec. 294(e) of the 1928 Revenue Act. The question was not before the Court of Appeals. The case has never been followed on that ground.

of that point whatsoever[7] or for the reasons stated in *In re Kallak, supra*.[8]

Consequently the only known grounds for the allowance of interest on tax claims during bankruptcy are those presented in the *Kallak* case and cases which adopted its reasoning.

2. Statutory Amendments Subsequent to *United States* v. *Childs, supra*:

The statutory changes enacted in 1926 and 1938 and the effect thereof on the *ratio* of the *Kallak* case were summarized by the Court of Appeals for the Second Circuit in *Sapery* v. *City of New York, supra*, as follows (p. 270):

> "In 1926, however, § 64, sub. a, was amended, by adding the words 'in the order of priority as set forth in paragraph (b)'; and of the seven

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[7] *Meilink* v. *Unemployment Reserves Com.*, 314 U. S. 564 (1942); *United States* v. *Childs, supra*; *People of the State of New York* v. *Jersawit*, 263 U. S. 493 (1924), (see *In re Semon, supra*, where the District Court stated as to the holding of this Court in the *Jersawit* case (p. 20) "There being no appeal by the trustee in bankruptcy, the allowance of 6% interest was permitted to stand."); *In re Beardsley & Wolcott Mfg. Co.*, 82 F. (2d) 239 (C. C. A. 2, 1936); *In re Martin*, 75 F. (2d) 618 (C. C. A. 7, 1935); *Horn & Boone County, Neb.*, 44 F. (2d) 920 (C. C. A. 8, 1930); *In re Standard Composition Co.*, 23 F. Supp. 391 (D. C. E. D. Mich., 1938); *In re A. E. Fountain*, 295 Fed. 873 (D. C. S. D. N. Y., 1924).

[8] *Dayton* v. *Stanard*, 241 U. S. 588 (1916); *In re J. Menist & Co., supra*, rev'd *sub nom. United States* v. *Childs, supra*; *In re Ajax Dress Co.*, 290 Fed. 950 (C. C. A. 2, 1923), rev'd *sub nom. People of the State of New York* v. *Jersawit, supra*; *In re Clark Realty Co.*, 253 Fed. 938 (C. C. A. 7, 1918); *In re L. Gandolfi & Co.*, 42 F. Supp. 706 (D. C. S. D. N. Y., 1940); *In re Ashland Emery & Corundum Co.*, 229 Fed. 829 (D. C. Mass., 1916).

priorities provided in b, taxes came sixth or next to the last. Even that change might have been considered sufficient to reduce taxes to the status of debts in view of the obvious doubt as to the payment of interest upon a sixth claim in a series where the earlier five admittedly carried none. Moreover, § 64, sub. b, spoke of the debts 'to have priority' in advance of the payment of dividends to creditors, 'and to be paid in full out of bankrupt estates,' in the order then stated; it was at least odd to think that a wage claim up to $600 was 'paid in full' when paid without interest, whereas a tax claim of later priority was not so paid until interest of 12 per cent or more was included.' But the issue did not come before the Supreme Court; and apparently the lower federal courts continued their former practice. *Cf. Horn* v. *Boone County, Neb.*, 8 Cir., 44 F. 2d 920; *In re Semon*, D. C. Conn., 11 F. Supp. 18, modified on other grounds 2 Cir., 80 F. 2d 81.

At any rate the process of assimilation of tax claims to other debts appears, to us at least, to have been completed by the Chandler amendments of 1938. Indeed we thus described the changes in *United States* v. *Roth*, *supra*, 164 F. 2d at pages 577, 578: 'By the 1938 amendments, however, taxes were classified as "debts" within section 64, sub. a, 11 U. S. C. A. § 104, sub. a, and section 57, sub. n, 11 U. S. C. A. § 93, sub. n, was broadened to include "all claims of the United States" and require them to "be proved and filed in the manner provided in this section."' Subdivision a of section 57, 11 U. S. C. A. § 93, sub. a, provides that a proof of claim shall state

among other matters "that the claim is justly owing from the bankrupt to the creditor"; * * * Thus it is apparent that the Act, as it now stands, treats the tax claim as a debt and the United States as a creditor which, like other creditors, must make proof of claim on a form prescribed by the Supreme Court. This, then, took from tax claims their former favored position where no proof or other governmental action was necessary for their enforcement. Thenceforth they must be proved, or otherwise be barred, just like other debts of the bankrupt.

[4] For the meaning of 'paid in full' as limited to the principal, see *Hammer* v. *Tufts*, *supra*, 145 F. 2d at page 449.

[5] In addition, by these amendments, the priority subdivision formerly paragraph 64b became paragraph 64a, and the classes of priorities were changed to five instead of seven, the status of tax claims being still next to the last or (4) instead of (6). This was no advancement in position, since former classes (1), (2), and (3) were combined with (1). In 1946, there was added to (1) 'the fees for the referees' salary fund and for the referees' expense fund.' (This note is not a part of the quotation.)"

The inescapable conclusion resulting from such statutory changes was stated by the Court of Appeals for the Second Circuit in the *Saper* case as follows (p. 270):

"We see no reason to suppose that this did not place tax claims in the same situation as other debts with respect to interest also.[6] The chief ground taken in *Davis* v. *Green*, *supra*, and the other cases which argue for the priority of interest, as well as principal, though conceding its inequity, is that Congress by failing to exclude it has re-enacted the old rule. It is dubious at best to rely upon such Congressional adoption where

'a close scrutiny of the various reports and hearings on the Chandler Act or its predecessor bills reveals nothing to indicate that the problem was ever under consideration.' 3 Collier on Bankruptcy, 1946 Cum. Supp., at n. 28a of par. 63.16; 61 Harv. L. Rev. 354. But it is submitted with deference that the pitch is on the other foot. When Congress provided that taxes must be proven like other debts and put them in, and well down in, a hierarchy of other claims, none of which bore interest, we think that like treatment was intended unless some specific exception was stated. This seems all the more likely when we recall the dubious and uncertain history of the original judicial exception.

This conclusion seems to us fortified by arguments of practicality and convenience—if not of equity, as stressed by Judge Bright—which would naturally appeal to legislators or draftsmen, if a careful exploration of the subject is to be attributed to them. Of course, the allowance of accruing interest to these various state and governmental units 'would necessitate' constant rescheduling and recomputation of dividends available.' 61 Harv. L. Rev. 354, 355. And the net result will be to promote tax claims beyond what seems the clear intent of the statute.' Moreover, with the very heavy interest rates now collected by states and municipalities and upheld in *Meilink* v. *Unemployment Reserves Commission of State of California*, 314 U. S. 564, it is apparent that any bankrupt estate whose settlement is delayed for any period of time is likely to be

eaten up by the accruing interest on the various taxes now levied against business enterprises.

[6] By making a tax claim a debt of the bankrupt it is brought within the terms of § 63, subd. a, 11 U. S. C. A. § 103, sub. a, defining provable debts, of which subd. (1) allows interest only up to the filing of the petition, and subd. (5) includes provable debts reduced to judgment after filing, i. e., less costs incurred and interest after the filing. Hence under subd. (5), when a tax claim is reduced to judgment after the filing, interest must be deducted. This points up the anomaly of another rule for tax claims not reduced to judgment.

[7] Assume a bankrupt to owe $1,000 to an employee for wages, $1,000 each to three taxing authorities, and $1,000 for rent given priority under state law. Under § 64, sub. a, which gives priority to the amount of $600 for wages and allows the others in order, these would be all paid in full if the assets were $5,000, and there were no other general claims beyond the $400 balance on the wage claim. But with interest allowed on the tax claims at 12% (or perhaps more) per annum during the bankruptcy, possible payments on the later claims would diminish in size as rapidly as Alice in Wonderland."

3. Refutation of Petitioners' Arguments on Effect of Chandler Act Amendments:

The principal reasons advanced by petitioners in an attempt to avoid the inescapable conclusion reached by the Court in *Saper* v. *City of New York*, *supra*, are:

1. The United States urges that in making a thorough revision of the Bankruptcy Act in 1938 the draftsmen must have been aware of the interest rule and that failure to amend that rule and specifically failure to change Section 57j indicated a contrary congressional intent.

This argument can be answered very briefly. In the first place, Section 57j has been proved to be irrelevant to the determination of the question at bar.

Secondly, the text writers in 3 Collier on Bankruptcy (14th Ed., 1946 Cum. Supp.), par. 63.16, replied to the same argument as advanced by the

Court in *Davie* v. *Green*, *supra*, as follows (p. 132, n. 28(a)):

> "Issue may be taken, however, with the Court in *Davie* v. *Green* on its conclusion that the draftsmen of the Chandler Act of 1938, or Congress, considered the doctrine in question and decided to affirm it. A close scrutiny of the various reports and hearings on the Chandler Act or its predecessor bills reveals nothing to indicate that the problem was ever under consideration, much less approved, unless silence is deemed to signify approval. It is quite enlightening that in *Matter of the D. O. Summers Co.*, cited and quoted in the Treatise, n. 24, Referee Friebolin—who was one of the principal draftsmen of the Chandler Act—made no mention of or reference to any discussion of the problem occurring during the drafting of the Act or its Congressional consideration. In light of his remarks regarding the doctrine, it is clear that he would have done so had the matter actually been raised and considered."

2. The United States urges that an intention to make a change adverse to it or to the states or their subdivisions should be supported by stronger evidence than presented by the Chandler Act amendments. The Court of Appeals for the Second Circuit answered this argument as follows in *Saper* v. *City of New York* (p. 271):

> "But it is submitted with deference that the pinch is on the other foot. When Congress provided that taxes must be proven like other debts and put them in, and well down in, a hierarchy of other claims, none of which bore interest, we

think that like treatment was intended unless some specific exception was stated. This seems all the more likely when we recall the dubious and uncertain history of the original judicial exception."

3. The United States urges that the decision of the Court of Appeals for the Second Circuit has granted a tax exemption on a mere implication.

It is respectfully submitted that this contention ignores the express provisions of Sections 57 n, 63 a and 64 a as discussed in the *Saper* case at page 270 n. 6 (p. 17, *supra*).

4. Petitioners unite in citing H. R. 5693 (80th Congress, 2d Sess.) and Report No. 2083 of the House Committee on the Judiciary with respect thereto as conclusive proof of congressional intent not to change the rule of the *Kallak* case by the 1938 amendments.

H. R. 5693 and Report 2083, on the contrary, support the contentions made by respondent.

The proposed amendment of Section 57j as contained in H. R. 5693, Section 11, is inconsistent with petitioners' interpretation of Section 57j in its present form. In the proposed amendment, the House of Representatives distinguished very sharply between debts owing as a penalty (subdivision (1)) and taxes due and owing (subdivision (2)). If petitioners were correct in their construction of Section 57j in its present form, there would be no need for subdivision (2), assuming without conceding that any amendment is required.

The report of the House Committee on the Judiciary agrees with the contentions of respondent and with the Court of Appeals for the Second Circuit in its deci-

sion in *Saper* v. *City of New York*, *supra*. It is clear from that report that the rule as to interest on delinquent tax debts is an exception to the general rule of interest on debts in bankruptcy; that the rule was of judicial origin; and most significantly that the changes in the Bankruptcy Act effected by the Chandler Act rendered the reasoning in the *Kallak* case obsolete.

The only issue therefore is whether the outmoded rule should be abrogated by this Court or whether legislative action must be taken.

4. Reasons for this Court to Act:

It is the function of the Courts to interpret congressional action. It is indisputable that the action taken by Congress in enacting the Chandler Act rendered the reasons for the rule urged by petitioners obsolete.

In numerous instances this Court, while conceding the power of Congress to enact remedial legislation, has asserted its own inherent power and responsibility to discard outmoded rules, without awaiting congressional action.

In *Aetna Portland Cement Co.* v. *Federal Trade Com'n*, 157 F. (2d) 533 (C. C. A. 7, 1946), the Court of Appeals in its majority opinion, set forth arguments with respect to the necessity of congressional action almost identical with those urged in the instant case (p. 573):

> "Furthermore, the basing point price system has been in use by industry for almost a half-century. There has been and is a marked diversity of opinion among economists, lawmakers and people generally as to whether it is good or bad.

Numerous bills have been introduced in Congress seeking to outlaw its use. Countless time has been spent in hearings by Congressional committees, before whom it has been assailed and defended. The pages of the Congressional Record bear mute but indisputable proof of the fact that Congress has repeatedly refused to declare its use illegal. There is no occasion to relate this Congressional history. It is a matter of common and general knowledge. In the *Corn Products* case, the court in commenting upon some of this legislative history stated (324 U. S. at page 737, 65 S. Ct. at page 967, 89 L. Ed. 1320): 'We think this legislative history indicates only that Congress was unwilling to require f. o. b. factory pricing, and thus to make all uniform delivered price systems and all basing point systems illegal *per se*.' Notwithstanding this Congressional attitude as recognized by the Supreme Court, this court is now urged to hold that the system is illegal *per se*, and to require that cement be sold on an f. o. b. plant basis.

In our judgment, the question as to whether the basing point price system should be declared illegal rests clearly within the legislative domain. We know of no criticism so often and so forcibly directed at courts, particularly Federal courts, as their propensity for usurping the functions of Congress. If this pricing system which Congress has over the years steadfastly refused to declare illegal, although vigorously urged to do so, is now to be outlawed by the courts, it will mark the high tide in judicial usurpation."

Nevertheless, on appeal *sub nomine Fed. Trade Com.* v. *Cement Institute*, 333 U. S. 683 (1948), this

Court reversed the Court of Appeals for the Seventh Circuit. There is no discussion of this point in the majority opinion of this Court but the above quoted argument was noted and quoted in footnote 11 in the dissenting opinion.

In *Erie R. Co.* v. *Tompkins*, 304 U. S. 64 (1938), Mr. Justice Reed in a concurring opinion overruling the long established doctrine of *Swift* v. *Tyson* stated (p. 92):

> "In this Court, stare decisis, in statutory construction, is a useful rule, not an inexorable command."

In *Funk* v. *United States*, 290 U. S. 371 (1933), this Court taking cognizance of altered conditions with respect to a common law rule as to competency of witnesses declared (p. 381):

> "It may be said that the court should continue to enforce the old rule, however contrary to modern experience and thought, and however opposed, in principle, to the general current of legislation and of judicial opinion, it may have become, leaving to Congress the responsibility of changing it. Of course, Congress has that power; but if Congress fail to act, as it has failed in respect of the matter now under review, and the court be called upon to decide the question, is it not the duty of the court, if it possess the power, to decide it in accordance with present day standard of wisdom and justice rather than in accordance with some outworn and antiquated rule of the past?"

In *Helvering* v. *Hallock*, 309 U. S. 106 (1940), this Court in rejecting the diversities taken in a former

opinion in applying an earlier doctrine of this Court stated (p. 122):

> "By imputing to Congress a hypothetical recognition of coherence between the Klein and the St. Louis Union Trust Co. Cases, we cannot evade our own responsibility for reconsidering, in the light of further experience, the validity of distinctions which this Court has itself created."

Moreover, in the instant case there is no change of position on the part of any municipal, State or Federal tax authority which might cause this Court to hesitate to change the rule which has ceased to have any reason for being perpetuated (*Cf. Helvering* v. *Hallock*, *supra*, 119-121).

Further reason may be found in the following pertinent statement in *In re Standard Composition Co.*, 23 F. Supp. 391 (D. C. E. D. Mich., 1938) (p. 395):

> "The Bankruptcy Act, 11 U. S. C. A. § 1 *et seq.*, was drafted with the principle that 'equality is equity' in mind, but there has been a tendency in recent years for the typical bankruptcy proceeding to resolve itself into a process in which one preferred party after another slices off a portion of the available assets, with little or none remaining for distribution to general creditors. This process ought not to be extended beyond the clear requirements of the controlling statutes."

5. Summary:

Respondent has conclusively established that the reasons for the rule urged by petitioners have been destroyed by the amendments to the Bankruptcy Act

in 1938. The report of the House Committee cited by petitioners concurs in that conclusion. The only remaining issue therefore is whether the obsolete rule should be abrogated by this Court or whether it requires congressional action at some indefinite future time. Precedent and reason indicate that this Court should abrogate this rule of judicial origin in order to prevent the perpetuation of further inequities, inconsistencies and anomalies resulting from its application.

III.

Equitable considerations of the instant case require the exercise of the Court's power to disallow tax claims to the extent of interest thereon for the period subsequent to the date of the filing of the petition in bankruptcy.

Both the District Court and the Court of Appeals held as a rule of general application that priority tax claims in bankruptcy should be treated no differently than other claims, insofar as interest is concerned. Respondent believes that the judgment appealed from should be affirmed on that ground.

Whether or not this Court determines to adopt the general rule, the judgment appealed from herein should be affirmed by reason of the equitable considerations present in the instant case.

1. Inherent and Statutory Equitable Power of the Court:

In *Continental Illinois Bank and Trust Co. v. Chicago Rock Island & Pacific Railway Company*, 294 U. S. 648 (1935), this Court held (p. 675):

"By § 2 of the Bankruptcy Act (U. S. C.

> title 11, § 11), courts of bankruptcy are invested 'with such jurisdiction at law and in equity as will enable them to exercise original jurisdiction in bankruptcy proceedings.' They are essentially courts of equity, and their proceedings inherently proceedings in equity, the words 'at law' probably having been inserted only with regard to clause (4) of § 2, which confers authority to arraign, try and punish bankrupts and others for violations of the act. * * *"

To the same effect, see *Pepper* v. *Litton*, 308 U. S. 295, 303 (1939); *Prudence Realization Corporation* v. *Geist*, 316 U. S. 89, 95 (1942); *Young* v. *Higbee Co.*, 324 U. S. 204, 214 (1945).

Section 57 k of the Bankruptcy Act (11 U. S. C., Section 93 k provides:

> "Claims which have been allowed may be reconsidered for cause and reallowed or rejected in whole or in part according to the *equities* of the case, before but not after the estate has been closed."

In the exercise of such equitable powers, the bankruptcy courts have in appropriate cases subordinated one creditor's claim to others to prevent a course of conduct which would be fraudulent or otherwise inequitable as to other creditors.

> *Heiser* v. *Woodruff*, 327 U. S. 726 (1946);
> *Pepper* v. *Litton*, *supra*;
> *Haussen* v. *Wingren*, 121 F. (2d) 1011 (C. C. A. 10, 1941), cert. den. *sub nom.* *Wingren* v. *Haussen*, 314 U. S. 683 (1941);

Corley v. *Cozart*, 115 F. (2d) 119 (C. C. A. 5, 1940);

Stone v. *Eacho*, 127 F. (2d) 284 (C. C. A. 4, 1942).

Thus it is incontrovertible that the bankruptcy court has both inherent and statutory powers to disallow a claim, whether priority or otherwise, in whole or in part, according to the equities of the case.

2. Equitable Considerations of the Instant Case:

There was unceasing litigation in the instant case for over six years (R. 4-5). By a petition verified October 25, 1940 a turnover proceeding was commenced against the bankrupt's president and a turnover order was procured on February 23, 1943 (R. 4). Appeals were taken by the bankrupt's president to the District Court, to the Court of Appeals and a petition for certiorari was filed with this Court which was denied (R. 4-5). Application was made to reopen the turnover proceeding and upon denial thereof further appeals ensued and another application was made to this Court for a writ of certiorari which was denied (R. 4-5). A contempt order was obtained by respondent and that too was the subject of appeals and an application for a writ of certiorari to this Court which was denied (R. 5).

As a direct result of that litigation over a period of six years, a settlement was procured resulting in the payment of $30,000.00 into the estate (R. 5, 6).

Prior to the receipt of the settlement the assets of the estate were approximately $20,000.00. (R. 6). The priority tax claims, namely those of the United States, the State of New York and The City of New York,

aggregated over $15,000.00 (R. 5, 6). Interest on the claims of the United States and of the State of New York to the date of the filing of the petition in bankruptcy aggregated over $1,200.00 (R. 6). Claims of general creditors aggregated approximately $74,000.00 (R. 5). Substantial administration expenses will have to be paid.

It would be unconscionable to permit priority tax claims to draw interest for the very period required to increase the estate to such an extent that it is enabled to pay not only principal of the tax claims in full, instead of just a portion thereof, but also interest for such period. "Such a ruling compels payment, not by the debtor whose debt it is, but by general creditors, who did not incur it, and who were not responsible for the delay in payment out of their otherwise fractional recovery on their own claims" (R. 16). It is manifestly inequitable and contrary to a fundamental principle of bankruptcy to permit priority creditors to benefit by reason of such unavoidable delay at the expense of general creditors (*Vanston Committee* v. *Green*, *supra*).

3. Refutation of Argument as to the Sufficiency of Estate:

The State of New York asserts at pages 11 and 12 of its Brief that respondent had sufficient assets prior to the receipt of the settlement to pay the priority tax claims and still have a balance of more than $3,563.55 for administration expenses.

That sum of less than $3,600.00 is obviously insufficient to cover the Referee's fees, Trustee's fees, fees to counsel and accountants for nine years of services (R. 3), and other administration expenses. In view of the manner in which the bankrupt's presi-

dent litigated the various issues (R. 546), respondent could not prudently have paid any claims because he could not prior to the settlement reasonably estimate the administration expenses which have first priority (Section 64(a) (1)). As soon as an acceptable offer of settlement was made, and even prior to its formal acceptance, when it became apparent that the question now before this Court was not merely an academic one, respondent moved promptly to object to the claims of the United States and the State of New York (R. 3).

4. Summary.

Petitioners have cited no authority which would controvert the inherent and statutory equitable powers of the bankruptcy court to disallow their claims to the extent of interest for the period after the filing of the petition in bankruptcy. Petitioners have advanced no arguments sufficient to overcome the overwhelming equities of the instant case.

CONCLUSION.

The judgment of the Court of Appeals for the Second Circuit should be affirmed.

Dated, New York, N. Y., December 3, 1948.

Respectfully submitted,

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APPENDIX.

Section 57 n of the Bankruptcy Act of 1898 was as follows:

"Claims shall not be proved against a bankrupt estate subsequent to one year after the adjudication; or if they are liquidated by litigation and the final judgment therein is rendered within thirty days before or after the expiration of such time, then within sixty days after the rendition of such judgment: *Provided*, That the right of infants and insane persons without guardians, without notice of the proceedings, may continue six months longer."

Section 57 n, as amended by the Chandler Act, is as follows:

"Except as otherwise provided in this Act, all claims provable under this Act, including all claims of the United States and of any State or subdivision thereof, shall be proved and filed in the manner provided in this section. Claims which are not filed within six months after the first date set for the first meeting of creditors shall not be allowed: * * *." [July 1, 1898, 30 Stat. at L. 544, chap. 541, § 57; Feb. 5, 1903, 32 Stat. at L. 797, chap. 487, § 12; May 27, 1926, 44 Stat. at L. 662, chap. 406, § 13; June 22, 1938, 52 Stat. at L. 802, chap. 575, § 1 (11 U. S. C. A. § 93).]

Section 64 of the Bankruptcy Act of 1898 was as follows:

"(a) The court shall order the trustee to pay all taxes legally due and owing by the bankrupt to

the United States, State, county, district, or municipality in advance of the payment of dividends to creditors, and upon filing the receipts of the proper public officers for such payment he shall be credited with the amount thereof, and in case any question arises as to the amount or legality of any such tax the same shall be heard and determined by the court.

(b) The debts to have priority; except as herein provided, and to be paid in full out of bankrupt estates, and the order of payment shall be (1) the actual and necessary cost of preserving the estate subsequent to filing the petition; (2) the filing fees paid by creditors in involuntary cases; (3) the cost of administration, including the fees and mileage payable to witnesses as now or hereafter provided by the laws of the United States, and one reasonable attorney's fee, for the professional services actually rendered, irrespective of the number of attorneys employed, to the petitioning creditors in involuntary cases, to the bankrupt in involuntary cases while performing the duties herein prescribed, and to the bankrupt in voluntary cases, as the court may allow; (4) wages due to workmen, clerks, or servants which have been earned within three months before the date of the commencement of proceedings, not to exceed three hundred dollars to each claimant and (5) debts owing to any person who by the laws of the States or the United States is entitled to priority."

Section 64, as amended in 1926, was as follows:

"(a) The court shall order the trustee to pay all taxes legally due and owing by the bankrupt

to the United States, State, county, district, or municipality, in the order of priority as set forth in paragraph (b) hereof: * * *.

(b) The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment shall be * * * (6) taxes payable under paragraph (a) hereof * * *."

Section 64, as amended by the Chandler Act, is as follows:

"(a) The debts to have priority, in advance of the payment of dividends to creditors, and to be paid in full out of bankrupt estates, and the order of payment shall be * * * (4) taxes legally due and owing by the bankrupt to the United States or any State or any subdivision thereof: * * *." [July 1, 1898, 30 Stat. at L. 544, chap. 541, § 64; Feb. 5, 1903, 32 Stat. at L. 797, chap. 487, § 14; May 27, 1926, 44 Stat. at L. 662, chap. 406; June 15, 1906, 34 Stat. at L. 267, chap. 3333; June 22, 1938, 52 Stat. at L. 802, chap. 5757, § 1 (11 U. S. C. A. § 104).]